TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 125

JOHN P. McLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF CALIFORNIA, PETITIONER

vs.

PACIFIC LUMBER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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INDEX

	Page
Record from D. C. U. S., Northern California	1
Complaint	1
Exhibit A—letter rejecting claim	12
Summons and return	15
Answer	16
Agreed statement of facts	22
Order for judgment	29
Judgment	29
Judgment as to interest	31
Bill of exceptions	32
Caption	32
Agreed statement of facts	32
Offers in evidence	39
Defendant's motion for nonsuit	40
Motions for judgment	40
Defendant's exceptions	41
Order settling bill of exceptions	42
Petition for appeal and order allowing same	43
Assignments of error	44
Notice of appeal	48
Praecipe for transcript of record	49
Clerk's certificate	50
Citation and service	51
Proceedings in U. S. C. C. A., Ninth Circuit	53

Page
Order of submission 53
Order directing filing of opinion and judgment 54
Opinion, Sawtelle, J 54
Judgment 60
Order denying petition for rehearing 60
Motion to recall mandate 61
Motion for leave to file petition for rehearing 61
Petition for rehearing 62
Order denying motions to recall mandate and file second petition for rehearing 66
Clerk's certificate 66
Order extending time within which to apply for writ of certiorari 67
Order allowing certiorari 68

NAMES AND ADDRESSES OF ATTORNEYS.

PILLSBURY, MADISON & SUTRO, EUGENE D. BENNETT, Esq., 225 Bush Street, San Francisco, California, Attorneys for Plaintiff and Appellee.

GEO. J. HATFIELD, U. S. Attorney, ESTHER B. PHILLIPS, Asst. U. S. Attorney, P. O. Building, San Francisco, California, Attorneys for Defendant and Appellant.

In the Southern Division of the District Court of the United States for the Northern District of California at Law.

No. 18,725-S

THE PACIFIC LUMBER COMPANY, a corporation,

Plaintiff,

vs.

JOHN P. McLAUGHLIN, as Collector of the United States Internal Revenue for the First District of California,

Defendant.

COMPLAINT FOR RECOVERY OF TAXES AND INTEREST.

Plaintiff above named complains of defendant above named and for cause of action alleges:

I.

That this is a case arising under the laws providing for internal revenue, to-wit: that it is an action brought against a Collector of Internal Revenue, under and by virtue of Sections 3220 and 3226 of the Revised Statutes of the United States, being Sections 149 and 156, respectively, of Title 26, entitled "Internal Revenue" of the Code of the Laws of the United States of America, approved June 30, 1926, to recover taxes and interest erroneously or illegally assessed or collected.

II.

That at all times hereinafter mentioned plaintiff was and now is a corporation organized and existing under and by virtue of the laws of the State of Maine, having its principal office in the First United States Revenue District of California.

III.

That defendant was at all times herein mentioned [1]* and now is the duly appointed, qualified and acting Collector of United States Revenue for the First District of California, having his office in the City and County of San Francisco, in the State and Southern Division of the Northern District of California, and is a citizen and resident of the State and Southern Division of the Northern District of California.

*Page numbering appearing at the foot of page of original certified Transcript of Record.

IV.

That plaintiff herein makes claim against defendant herein for a refund from such defendant of the sum of $143,122.23 as and for income tax overpaid by said plaintiff to said defendant for the calendar year 1923, and that the facts in respect thereto are these:

That on or about the 20th day of March, 1924, plaintiff filed in the office of defendant, as aforesaid collector, a return of net income in the amount of $1,158,362.46 as and for plaintiff's taxable net income for said calendar year. That plaintiff paid to defendant, as aforesaid collector, the total amount of $144,795.31, as and for the total income tax for said calendar year on said amount reported as net income as aforesaid. That plaintiff paid said total amount of $144,795.31 of income tax in four installments in the respective amounts of $36,200., $36,-198.44, $36,198.44 and $36,198.43 on or about the 15th day of March, 1924, the 14th day of June, 1924, the 13th day of September, 1924, and the 13th day of December, 1924, respectively. That thereafter plaintiff received from the Supervising Internal Revenue Agent at San Francisco an examination report dated January 13, 1927, covering plaintiff's taxable net income for said calendar year. That said examination report set forth corrected net income in the amount of $1,144,977.80 as taxable to plaintiff for said calendar year, and set forth the amount of $143,122.23 as and for the total [2]

income tax upon said corrected net income. That on or about the 30th day of April, 1928, plaintiff received from defendant a refund in the amount of $1,673.08, with interest thereon, on account of the difference between said total income tax upon said corrected net income and said total amount of $144,795.31, paid by plaintiff as aforesaid. That thereafter, to-wit, on or about the 14th day of March, 1928, plaintiff filed with defendant, as aforesaid collector, and thereafter defendant transmitted to the Commissioner of Internal Revenue, an appeal in the form of a claim for refund of said total amount of $143,122.23 of income tax as aforesaid paid and unrefunded, together with interest thereon in the amount of $37,645.90, or a total of $180,768.13 of taxes and interest. That said appeal to the Commissioner of Internal Revenue was made according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and was in the words and figures as follows, to-wit:

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
Form 843—Jan. 1922
Comptroller General U. S.
January 18, 1922

(EXECUTE SEPARATE FORM FOR EACH TAX PERIOD)

CLAIM FOR

- [ ] ABATEMENT OF TAX ASSESSED
- [ ] CREDIT AGAINST OUTSTANDING ASSESSMENTS
- [ ] REFUND OF TAXES ILLEGALLY COLLECTED
- [ ] REFUND OF AMOUNTS PAID FOR STAMPS USED IN ERROR OR EXCESS

IMPORTANT

File with Collector of Internal Revenue where assessment was made. Not acceptable unless completely filled in.

COLLECTOR'S NOTATION	
District	
Account number	
Date received	RECEIVED MAR. 14,1928 1st DIST. CALIFORNIA
Stamp here	
	J.M. REICHLIN, Collector of Internal Revenue
	Deputy Collector

State of California } ss:
County of San Francisco

NOTICE TO COLLECTOR

Collector must indicate in block above the kind of claim, except in Income Tax cases.

Date received by Administrative Unit

Stamp here

TYPE OR PRINT

The Pacific Lumber Company
(Name of taxpayer or purchaser of stamps.)

311 California Street
(Residence - give street and number as well as city or town and State.)

San Francisco, California
(Business address.)

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

PERIOD		YEAR
From:	Jan. 1st	1923
To:	Dec. 31st	1923

1. Business in which engaged Lumber Production & Manufacture
2. Character of assessment or tax Corporation Income Tax
(State for or upon what the tax was assessed or the stamps affixed.)
3. Amount of assessment or stamps purchased $
4. Reduction of Tax Liability requested (Income and Profits Tax) $
5. Amount to be abated $
6. Amount to be refunded (or such greater amount as is legally refundable) $180,768.13
7. Dates of payment (see Collector's receipts or indorsements of canceled checks)
(If statement covers income tax liability, items 8-11, inclusive, must be answered.)
8. District in which return (if any) was filed
9. District in which unpaid assessment appears
10. Amount of overpayment claimed as credit $
11. Unpaid assessment against which credit is asked; period from to $

Deponent verily believes that this application should be allowed for the following reasons:

A. F. Thane & Company, a corporation, was incorporated on or about June 24, 1911. Its authorized capital stock was $100,000. divided into 1000 shares of the par value of $100. each. At the time of the incorporation 220 shares of its stock were subscribed for and issued. The taxpayer subscribed for and took 110 shares of such stock, and paid for the same the full par value thereof, viz., $11,000. During the year 1912, 280 additional shares of the stock of A. F. Thane & Company were issued, and the taxpayer subscribed for and took one-half thereof, viz., 140 shares; paying for the same the full par value thereof, viz., $14,000. During the year 1913, 30 additional shares of the stock of A. F. Thane & Company were issued, and the taxpayer subscribed for and took 15 shares thereof, paying for the same the full par value thereof, viz., $1,500. During the year 1914 an additional 10 shares of the stock of A. F. Thane & Company were issued, and the taxpayer subscribed for and took the same, paying therefor in cash the full par value thereof, viz., $1,000. In the same year (1914), the taxpayer purchased the remainder of the outstanding stock of A. F. Thane & Company, then held by Charles Nelson Company; and paid for the same the sum of $4,000; making its total actual investment in such stock at the end of 1914, $31,500.; its total holdings at that time being 540 shares, which constituted all of the shares of stock then issued and outstanding.

During the year 1919 the capital stock of A. F. Thane & Company was increased to $500,000., con-

sisting of 5,000 shares of the par value of $100. each. In that year and during the years 1920 and 1921 the taxpayer subscribed for and took in all 4,460 shares of such stock and paid therefor the full par value of the same, viz., $446,000. [4] Therefore the total investment of the taxpayer in the stock of A. F. Thane & Company, from the beginning, was $479,625., representing the actual cost of such stock to the taxpayer. In 1921 and at all times thereafter, until the dissolution of A. F. Thane & Company in 1923, the taxpayer owned and held all of the stock of said A. F. Thane & Company, consisting of 5,000 shares of the par value of $100. each.

In 1918 the capital of A. F. Thane & Company was intact and it had accumulated a substantial surplus. Its business had greatly expanded and it was believed that it was making substantial earnings during 1919 and 1920. But by reason of the great depression which occurred in the latter part of the year 1920, A. F. Thane & Company sustained enormous losses. By the end of the year 1921 the taxpayer recognized that the losses sustained by A. F. Thane & Company were such that its assets would not be more than sufficient, in any event, to liquidate its indebtedness; and the taxpayer's officers believed that the taxpayer's investment in the stock of A. F. Thane & Co. would result in complete loss. Therefore, the taxpayer charged off, as a loss in 1921, the entire amount of its investment in such stock. The Revenue Agent subsequently

held that whatever loss the taxpayer may have sustained from its investment in A. F. Thane & Co., stock was not properly attributable to the year 1921, inasmuch as A. F. Thane & Co., was still a going concern having substantial assets; and that no loss on account of such investment was properly deductible in 1921, nor until 1923, in which year the affairs of A. F. Thane & Co., were liquidated.

The taxpayer now concedes that this ruling was correct, but asserts that it is entitled to a deduction in [5] the year 1923 of the amount of its losses from the investment in such stock.

During the few years immediately preceding the year 1923 the taxpayer made advances to A. F. Thane & Co. amounting in the aggregate, over and above all repayments and recoveries, to $953,135.49. These advances were made in good faith, for the purpose of protecting the taxpayer's investment, and with an expectation of profit. In the year 1923 the business and affairs of A. F. Thane & Co., were liquidated and closed up, and the corporation dissolved. No assets whatever belonged to A. F. Thane & Co. after such liquidation, which liquidation was wholly completed before the end of the year 1923.

At no time prior to the year 1923 was it reasonably certain that the taxpayer would not recover a substantial part of its said advances, although it was recognized prior to that year that complete recovery was not reasonably probable.

In closing its books at the end of the year 1923 the taxpayer, having previously ascertained and

determined that the debt to it by A. F. Thane & Co. for the amount stated above was worthless, charged off on its books the entire amount of such indebtedness as a bad debt. The taxpayer respectfully asserts that it is entitled to a deduction from gross income for the year 1923 of the entire amount of its said investment in the stock of A. F. Thane & Co. viz., $479,625. as a loss sustained in that year.

The taxpayer further asserts that it is entitled to a deduction from gross income in the year 1923, as a bad debt, ascertained to be worthless and charged off within the year, of the amount of its said advances to [6] A. F. Thane & Co. in the sum of $953,135.49.

.....

(Attach additional sheets if necessary)

Sworn to and subscribed before me this.....day of ....., 19.....

.....

.....

(Title)

Signed: THE PACIFIC LUMBER COMPANY.

.....

....." [7]

That the statements made in said appeal and claim for refund are in all respects full, true and correct. That said appeal and claim was thereafter considered by the Commissioner of Internal Revenue and was by him wrongfully and erroneously

rejected and disallowed on or about the 4th day of June, 1928, by a communication, a copy whereof is hereto annexed and marked Exhibit "A" and is hereby referred to and made a part hereof. That no part of said amount of $1,158,362.46 reported by plaintiff as and for plaintiff's taxable net income, nor of said amount of $1,144,977.80 so reported by said supervising Internal Revenue Agent as and for plaintiff's corrected taxable net income, nor of either of them, was taxable to plaintiff for the following reasons, to wit:

That said amounts and each of them were offset by advances made by plaintiff in the amount of $953,135.49 to A. F. Thane & Company and by the cost to plaintiff in the total amount of $479,625. of stock of said A. F. Thane & Company. That plaintiff is entitled to deduct from the gross income reported for said calendar year said respective amounts of $953,135.49 and $479,625. That plaintiff is entitled to deduct said amounts for the reasons set forth in the aforesaid appeal and claim for refund.

That no taxable net income in any amount whatever was received by or accrued to plaintiff during said calendar year. That no federal income tax whatever was ever due or owing by plaintiff for said calendar year. That the collection of said tax by defendant as aforesaid, was unauthorized, erroneous and illegal for each of the reasons mentioned and set forth in said claim for refund, and for the reasons herein set forth. That by reason thereof

said defendant became liable and is bound by law to refund and to pay to plaintiff the total amount of said tax overpaid and unrefunded, as aforesaid, in the amount of $143,122.23, with lawful interest thereon. [8] That no part of the aforesaid amount of $143,122.23 has been refunded or repaid to plaintiff by defendant and the whole amount thereof, with interest thereon from dates of payment, remains due and owing from this defendant to this plaintiff. Wherefore plaintiff brings this action in this court pursuant to the statutes of the United States to recover said internal revenue tax illegally assessed and/or collected.

WHEREFORE, plaintiff prays judgment against defendant in the sum of one hundred forty-three thousand one hundred twenty-two and 23/100 dollars ($143,122.23) with legal interest and costs of this suit.

PILLSBURY, MADISON & SUTRO,
Attorneys for Plaintiff.[9]

State of California,
City and County of San Francisco.—ss.

W. N. Nelson, being first duly sworn, deposes and says:

That he is an officer, to-wit, the Ass't. Secretary-Treasurer of the Pacific Lumber Company, a corporation, the above-named plaintiff; that he has read the foregoing complaint and knows the contents thereof; that the same is true of his own knowledge, except as to those matters which are

therein stated on his information or belief and as to those matters that he believes it to be true.

W. N. NELSON.

Subscribed and sworn to before me this 19th day of May, 1930.

[Seal] CON. T. SHEA,
Notary Public in and for the City and County of San Francisco, State of California. [10]

EXHIBIT "A."

Treasury Department
Washington
Office of
Commissioner of Internal Revenue
Address Reply to
Commissioner of Internal Revenue
and refer to—IT:AR:G-4
HWG May 24, 1928

Pacific Lumber Company,
311 California Street
San Francisco, California

Sirs:

Your claim filed March 14, 1928 for the refund of $180,768.13, corporation income tax for the year 1923, has been examined.

The claim is based upon the statements that you owned the entire capital stock of A. F. Thane and Company, consisting of 5,000 shares of the par value of $100.00 each, acquired at a cost to you of $479,-625.00, and that you had loaned to A. F. Thane and

Company the amount of $953,135.49; that in 1923 A. F. Thane and Company became insolvent and was dissolved, leaving no assets; and that you are entitled to deduct from your 1923 net income, as losses, the foregoing amounts of $479,625.00 and $953,135.49, resulting in an overassessment of $180,768.13.

The deductions in question were disallowed by this office in the audit of the return.

The contentions in the claim appear to come within the scope of published rulings of the General Counsel, Bureau of Internal Revenue, and of the United States Board of Tax Appeals, as follows:

1. The liquidation of a subsidiary does not produce a loss which is deductible by the parent company. See G. C. M. 1501 (Internal Revenue Cumulative Bulletin VI-1, page 262) and United States Trust Company (1 B. T. A. 904), which sustain the Commissioner on this issue.

2. If one member of an affiliation makes advances to another member to meet operating losses occurring during the period of affiliation, the intercompany obligation thus arising may not be deducted by the corporation making the advance after the obligation has been determined to be worthless. See Gould Coupler Company (5 B. T. A. 518), which sustains the Commissioner.

In brief dated March 18, 1927 you contend that you are equitably entitled to a loss on your capital investment due to liquidation of the subsidiary for

the reason that you would undoubtedly be entitled to a loss if the stock were sold to a third party at less than its cost to you. In this connection the United States Board of Tax Appeals has ruled that affiliated corporations are, for the purpose of income taxes, one and the same taxpayer; the sale by a parent company of its capital stock holdings in a subsidiary company must be treated, for the purpose of the tax, as nothing more than a sale by the affiliated group of its own capital stock; and that such a sale is a capital transaction which cannot give rise to a taxable gain or a [11] deductible loss. See Appeal of Farmers Deposit National Bank, 5 Board of Tax Appeals, 528, decided November 16, 1926, and Article 543 of Regulations 62.

Since A. F. Thane and Company was affiliated with your company and due allowance was made in computing consolidated net income, for all deductible losses sustained by the subsidiary during the several years, a further deduction, reflecting directly or indirectly the same losses, is, in accordance with the foregoing decisions, not allowable.

The claim will, therefore, be rejected.

The rejection will officially appear on the next schedule to be approved by the Commissioner.

Respectfully,

C. B. ALLEN,
Deputy Commissioner.
By H. B. Robinson,
Head of Division.

[Endorsed]: Filed May 21, 1930. [12]

[Title of Court and Cause.]

SUMMONS.

The President of the United States of America.

To John P. McLaughlin, as Collector of the United States Internal Revenue for the First District of California, defendant.

YOU ARE HEREBY DIRECTED TO APPEAR AND ANSWER the Complaint in an action entitled as above, brought against you in the District Court of the United States, in and for the Northern District of California, Southern Division, within ten days after the service on you of this Summons, if served within this county, or within thirty days if served elsewhere.

And you are hereby notified that unless you appear and answer as above required the said plaintiff will take judgment for any money or damages demanded in the Complaint, as arising upon contract or it will apply to the Court for any other relief demanded in the Complaint.

WITNESS the Honorable A. F. St. Sure, Judge of said District Court, this 21st day of May in the year of our Lord one thousand nine hundred and thirty and of our independence the one hundred and 54th.

[Seal] WALTER B. MALING,
Clerk,
By R. M. GREEN,
Deputy Clerk. [13]

United States Marshal's Office,
Northern District of California.

I hereby certify that I received the within writ on the 22nd day of May, 1930, and personally served the same on the 22nd day of May, 1930, upon Jno. P. McLaughlin by delivering to, and leaving with V. Coutts, Secy. to Jno. P. McLaughlin, said defendant named therein personally, at the city and County of S. F. in said District a certified copy thereof, together with a copy of the Complaint, attached thereto.

FRED L. ESOLA,
U. S. Marshal,
By HAROLD FRIEDENBERG,
Office Deputy.

San Francisco, May 23, 1930.

[Endorsed]: Filed May 23, 1930. Walter B. Maling, Clerk, by R. M. Green, Deputy Clerk.

[Title of Court and Cause.]

ANSWER.

The defendant above named answering the complaint heretofore filed in this case, alleges as follows:

I.

Denies that the taxes and interest referred to in paragraph I of the complaint were erroneously or illegally assessed and collected. Admits the remaining allegations of said paragraph.

II.

Admits the allegations of paragraph II of the complaint.

III.

Denies that the defendant was the duly appointed, qualified and acting Collector of the United States Revenue for the First District of California at any time prior to November, 1921. Saving for this denial, defendant admits the allegations of paragraph III of the complaint. [14]

IV.

Admits that this suit is a claim for a refund from the defendant of the sum of $143,122.23 as and for income tax paid to the defendant for the calendar year 1923. Denies that said income tax was overpaid and denies that the facts with respect thereto are as stated in the complaint.

Admits that plaintiff filed a return of net income in the amount of $1,158,362.46, as and for plaintiff's taxable net income for the calendar year 1923. Denies that said return was filed on or about March 20, 1924. Defendant alleges that said return was filed on or about April 14, 1924, and that said return was a consolidated return filed on behalf of the plaintiff and its affiliated corporations, and that said taxable net income was made up as follows:

Pacific Lumber Company (Maine)	$1,379,494.78
Pacific Lumber Company of Illinois	8,809.83
	$1,388,304.61
Less: Loss of A. F. Thane & Company	229,942.15
Consolidated net taxable income	$1,158,362.46

Admits that plaintiff paid to the defendant in his capacity as Collector of Internal Revenue, the sum of $144,795.31 as and for the total income tax for the calendar year 1924 on said amount reported in said consolidated return as net income. Admits that plaintiff paid said amount in four installments in the amounts and on or about the dates set forth in Paragraph IV of the complaint. Defendant admits that plaintiff received from the Supervising Internal Revenue agent at San Francisco [15] an examination report covering plaintiff's taxable net income for said calendar year. Denies that said report was dated January 13, 1927, and alleges that the same was dated December 4, 1926. Defendant further alleges that said report covered an examination of the income tax liability for the calendar year 1923 of certain companies affiliated with the plaintiff corporation. Defendant admits that said examination report set forth a corrected net income in the amount of $1,144,977.80 for said calendar year 1924, and that said report showed the amount of $143,122.23 as the total income tax upon such corrected net income. Defendant denies that said

report set forth such corrected net income as taxable to the plaintiff and alleges that in arriving at said corrected net income, said Revenue Agent included therein without change, the net income and net loss reported in the consolidated return by the Pacific Lumber Company of Illinois and A. F. Thane & Co., respectively, as hereinabove set out, and that the reduction therein made affected the income of the plaintiff corporation only. Defendant admits that on or about April 30, 1928, the plaintiff received from defendant a refund in the amount of $1,673.08 with interest thereon on account of the difference between said total income tax upon said corrected net income and the total amount of $144,795.31 previously paid by plaintiff.

Defendant admits that thereafter and on or about March 14, 1928, plaintiff filed with the defendant and thereafter defendant transmitted to the Commissioner of Internal Revenue, a claim for a refund of income tax paid for the calendar year 1923. Defendant admits that the total amount of said claim for refund was $180,768.13 and that said claim for refund covered all income tax as paid afore- [16] said, and unrefunded. Defendant denies that said claim purported to be for the respective amounts of income tax, $143,122.23 and interest thereon in the sum of $37,645.90. Defendant denies that said claim for refund constituted an appeal by the plaintiff. Defendant admits that the words and figures appended to page 3 of the complaint as

quoted on pages 4, 5, 6 and 7 of the complaint, represent a true and correct copy unexecuted of the aforesaid claim for refund. The defendant denies that this claim for refund was an appeal to the Commissioner of Internal Revenue made according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof.

Defendant admits that the Commissioner of Internal Revenue considered said claim for refund and that he rejected and disallowed the same on or about June 4, 1928, and that in this connection a communication was addressed to the plaintiff, a correct copy of which is annexed to the complaint and marked "Exhibit A". Defendant denies that the statements made in said claim for refund were in all respects full, true and correct and denies that the Commissioner of Internal Revenue erroneously refused and/or rejected and disallowed the same. Defendant admits that no part of said sum of $143,-122.23 with interest thereon has been refunded or repaid to the plaintiff by the defendant. Defendant denies the allegation in the complaint that no taxable net income in any amount was received by or accrued to plaintiff during said calendar year and that no income tax whatever was due or owing by plaintiff for said calendar year. Plaintiff denies the allegation in the complaint that the amount reported by said Supervising [17] Internal Revenue agent amounting to $1,144,977.80 was not taxable to the

plaintiff. Defendant denies that plaintiff is entitled to deduct from the gross income reported for said calendar year the amounts of $953,135.49 and $479,-625.00, which said amounts are alleged to have been advanced by plaintiff to A. F. Thane & Company and as the cost to plaintiff of stock in said A. F. Thane & Company, respectively.

Saving the express admissions made herein, defendant denies each and every allegation in Paragraph IV of the complaint.

WHEREFORE defendant prays that judgment be entered for the defendant and for its costs and for such other relief as may be just.

GEO. J. HATFIELD,
United States Attorney.
ESTHER B. PHILLIPS,
Asst. U. S. Attorney. [18]

United States of America,
Northern District of California,
City and County of San Francisco.—ss.

John P. McLaughlin being first duly sworn, deposes and says:

That he is the above named defendant; that he has read the foregoing answer and knows the contents thereof. The same is true of his own knowledge except as to those matters stated on information and belief and as to those matters he believes it to be true.

JOHN P. McLAUGHLIN,

Subscribed and sworn to before me this 5th day of August, 1930.

[Seal] RAYMOND HASKINS,
Notary Public in and for the City and County of San Francisco.

Service of the within answer by copy admitted this 5 day of Aug. 1930.

PILLSBURY, MADISON & SUTRO,
Attorney for Plf.

[Endorsed]: Filed Aug. 5, 1930. [19]

[Title of Court and Cause.]

AGREED STATEMENT OF FACTS.

IT IS HEREBY STIPULATED AND AGREED that the above entitled case may be tried by the court sitting without a jury. It is further stipulated and agreed by and between the parties hereto that the following facts are true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce further evidence not inconsistent with the facts herein stipulated, or as admitted in the pleadings.

I.

At all times herein mentioned plaintiff was and is a corporation organized and existing under and by virtue of the laws of the State of Maine, and having its principal office in the First United States Revenue District of California. That defendant now

is and at all times since November 21, 1921, has been the duly appointed, qualified and acting Collector of United States Revenue for the First District of California, having his office in the City and County of San Francisco in the Southern Division of the Northern District of California, and is a citizen and resident of the State of California and of the Southern Division of the [20] Northern District of California.

II.

During the year 1918, A. F. Thane & Company, a corporation organized and existing under and by virtue of the laws of the State of California, had an authorized capital stock of 1,000 shares of the par value of $100 each, of which 600 shares were issued and outstanding. The plaintiff Pacific Lumber Company owned 540 shares, which it had purchased from said A. F. Thane & Company at a cost of $31,500.00. A. F. Thane owned the remaining 60 shares. In 1920, the capital stock of A. F. Thane & Company was increased to 5,000 shares of the par value of $100 each. Pacific Lumber Company subscribed for 3960 additional shares, for which it paid $100 each, making its total holdings 4500 shares. A. F. Thane subscribed for additional stock, making his total holdings 500 shares. In 1921 Pacific Lumber Company purchased A. F. Thane's holdings and paid $52,125.00. The total sum paid by Pacific Lumber Company for the 5,000 shares of stock which it owned at the end of 1921 was $479,-625.00.

III.

During the period between March 17, 1921, and the close of December, 1923, Pacific Lumber Company and A. F. Thane & Company had financial arrangements with each other by which Pacific Lumber Company from time to time advanced cash to A. F. Thane & Company, paid accounts for, and assumed indebtednesses of A. F. Thane & Company which it had guaranteed, the total sum of such cash advances, accounts paid and indebtednesses assumed amounting to $1,234,157.09. A. F. Thane & Company from time to time during this interval made partial repayments of said advances, accounts, etc., the total of which repayments [21] at the close of December, 1923, amounted to $260,461.88. At the close of 1923 A. F. Thane & Company was duly dissolved by order and decree of the Superior Court of the City and County of San Francisco, State of California, and was liquidated by transfer of all of its remaining assets to Pacific Lumber Company and by closing its books and ceasing to do business. At the close of the year 1923 the assets thus transferred to Pacific Lumber Company consisted of cash $1,240.67; furniture and fixtures valued on the books of A. F. Thane & Company at $9,682.23; accounts receivable valued on the books of A. F. Thane & Company at $2,731.73, notes receivable valued on the books of A. F. Thane & Company at $3,220.60; claims pending settlement valued on the books of A. F. Thane & Company at $3,685.49. The total value at which these assets were carried on

A. F. Thane & Company's books and at which value they were taken over in liquidation by Pacific Lumber Company was $20,560.72. These assets, so valued, were applied by Pacific Lumber Company on its books to the advances, accounts paid and other indebtednesses of A. F. Thane & Company to Pacific Lumber Company.

The net amount due to Pacific Lumber Company from A. F. Thane & Company as a result of all the transactions enumerated hereinabove (Paragraph III) was $953,134.49. The Pacific Lumber Company left as an asset on its books the sum of $1 to reflect the value of its stock holdings in A. F. Thane & Company and the sum of $1 to reflect the value of the accounts receivable of A. F. Thane & Company. Pacific Lumber Company, plaintiff herein, at the close of 1923 charged off on its books the balance, to wit, $953,134.49, as a debt ascertained to be worthless during the tax year 1923. [22]

IV.

During the years 1920, 1921, 1922 and 1923, the plaintiff the Pacific Lumber Company of Maine was affiliated with A. F. Thane & Company and the Pacific Lumber Company, an Illinois corporation. Separate tax returns were filed by each of these companies and a consolidated return was filed, showing the operations of the three companies. Taxes were paid upon the net income shown in the consolidated returns. The separate and consolidated returns showed the following:

For the tax year 1920 Pacific Lumber Company of Maine, separate return, reported net income $2,-262,959.39; Pacific Lumber Company of Illinois separate return a loss amounting to $23,052.35; A. F. Thane & Company separate return net loss $443,-821.95; total net loss $466,874.30. The consolidated return of the three companies reported a net profit of $1,796,085.09 and taxes were paid upon this last amount.

For the tax year 1921, the Pacific Lumber Company of Maine, separate return, reported net income $579,624.88; Pacific Lumber Company of Illinois, separate return, reported net income $18,-314.97; A. F. Thane & Company, separate return, reported a net loss $548,166.82. The consolidated return of the three companies showed a net loss of $150,226.97 and no tax was paid.

For the tax year 1922 the Pacific Lumber Company of Maine upon its separate return showed a net income of $1,266,450.31. The Pacific Lumber Company of Illinois by its separate return showed a net income of $31,198.03; A. F. Thane & Company by its separate return reported a net loss of $344,-791.49. The consolidated returns of the three companies showed a net income amounting to $952,-857.05. Upon the consolidated return the consolidated net loss for 1921, amounting to $150,226.97 was carried forward, as permitted by law, and the total net profit, [23] upon which taxes were paid for the tax year 1922 was $802,630.08.

For the tax year 1923, the Pacific Lumber Company of Maine, separate return, showed a net income of $1,379,494.78. The separate return of the Pacific Lumber Company of Illinois showed a net income of $8,809.83. A. F. Thane & Company, separate return, showed a net loss of $229,942.15. The net income shown upon the consolidated return for the three companies for the tax year 1923 amounted to $1,138,362.46. Said consolidated return, with separate returns was filed on or about April 14, 1924. Upon said consolidated net income of $1,158,362.46 the Pacific Lumber Company paid to the defendant the sum of $144,795.31 as the total income tax for the calendar year 1923, said amount being paid as follows:

March 20, 1924	$36,200.00
June 1, 1924	$36,198.44
Sept. 15, 1924	$36,198.44
Dec. 7, 1924	$36,198.43

Thereafter on or about April 30, 1928, upon an examination and an audit by the supervising Internal Revenue Agent at San Francisco, plaintiff's corrected net income for the year 1923 was found to be $1,144,977.80 as taxable for said year 1923, and the amount of $143,122.23 was found to be the total amount of income tax due upon said corrected net income. Plaintiff received from defendant a refund in the amount of $1,673.08, with interest thereon, on account of the difference between the total income tax shown to be payable upon said corrected net income and the amount shown to be payable

upon the original return. Said correction arose by reason of the supervising agent allowing the plaintiff a larger amount of depreciation upon certain of plaintiff's lumber properties than plaintiff had claimed in [24] its original return.

The details of the foregoing facts are shown in the income tax returns for the several years in question.

V.

On or about March 14, 1928, plaintiff filed with defendant and thereafter defendant transmitted to the Commissioner of Internal Revenue, a claim for refund of said total amount of $143,122.23 of income tax theretofore paid, together with interest thereon in the sum of $37,645.90, or a total of $180,768.13. Said claim was made pursuant to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof. Thereafter said claim for refund was rejected and disallowed by the Commissioner of Internal Revenue on or about June 14, 1928. No part of the aforesaid sum of $143,122.23 and no part of the interest thereon has been refunded or repaid to plaintiff by defendant.

PILLSBURY, MADISON & SUTRO,
(Attorneys for Plaintiff)
GEO. J. HATFIELD,
ESTHER B. PHILLIPS,
(Attorneys for Defendant)

[Endorsed]: Filed February 19, 1931. [25]

[Title of Court and Cause.]

ORDER FOR JUDGMENT.

ORDERED that plaintiff have judgment against defendant in the sum of one hundred forty-three thousand one hundred twenty-two and 23/100 (143,122.23) dollars with legal interest and costs of suit.

Let judgment be entered accordingly.

Dated, January 13, 1932.

A. F. ST. SURE,
U. S. District Judge.

[Endorsed]: Filed Jan 14, 1932. [26]

In the Southern Division of the United States District Court for the Northern District of California.

No. 18,725-S.

THE PACIFIC LUMBER COMPANY, a corporation,

Plaintiff,

vs.

JOHN P. McLAUGHLIN, as Collector of the United States Internal Revenue for the First District of California,

Defendant.

JUDGMENT.

This cause having come on regularly for trial on the 19th day of February, 1931, before the court

sitting without a jury, a trial by jury having been waived by oral stipulation, Eugene D. Bennett, Esq., appearing as attorney for plaintiff, and Esther B. Phillips, Assistant United States Attorney, appearing as attorney for defendant, and the trial having been proceeded with, and documentary evidence and an agreed statement of facts having been introduced and closed, and the cause having been submitted to the court for consideration and decision, and the court on the 13th day of January, 1932, after due deliberation having rendered its decision and ordered that judgment be entered herein in favor of plaintiff as prayed for the sum of one hundred forty-three thousand one hundred twenty-two and 23/100 dollars ($143,122.23), as principal, with interest thereon to the 13th day of January, 1932, in the total sum of sixty-four thousand nine hundred seventy-seven and 53/100 dollars ($64,977.53), with interest on said sums from the 13th day of January, 1932, at six per cent (6%) per annum until paid, together with costs; [27]

NOW, THEREFORE, by virtue of the law and by reason of the premises aforesaid, it is considered by the court that The Pacific Lumber Company, a corporation, plaintiff, do have and recover of and from John P. McLaughlin, as Collector of the United States Internal Revenue for the First District of California, defendant, the sum of one hundred forty-three thousand one hundred twenty-two and 23/100 dollars ($143,122.23) with interest

thereon to the 13th day of January, 1932, in the total sum of sixty-four thousand nine hundred seventy-seven and 53/100 dollars, ($64,977.53), and with interest on the said sums from the 13th day of January, 1932, at the rate of six per cent (6%) per annum until paid, together with its costs herein expended taxed at $

Judgment entered this 14th day of January, 1932.

WALTER B. MALING,
Clerk. [28]

[Title of Court and Cause.]

JUDGMENT AS TO INTEREST.

ORDERED that the interest recoverable by the plaintiff against the defendant on the sum of one hundred forty-three thousand one hundred twenty-two and 23/100 dollars ($143,122.23) under the judgment rendered on January 13, 1932, shall be computed from the respective dates on which the said sum was paid by plaintiff to defendant under protest, and to and including the 13th day of January, 1932, with interest on the sum so computed at six (6) per cent until paid.

Dated, January 18, 1932.

A. F. ST. SURE,
United States District Judge.

[Endorsed]: Filed Jan 20, 1932. [29]

[Title of Court and Cause.]

BILL OF EXCEPTIONS.

BE IT REMEMBERED, that this cause came regularly on for trial on the 19th day of February, 1931, before the above-entitled court, Honorable A. F. St. Sure presiding, jury being waived by the parties, the plaintiff appearing by its attorneys, Messrs. Pillsbury, Madison & Sutro and Eugene D. Bennett, and the defendant appearing by his attorneys, Geo. J. Hatfield, United States Attorney, and Esther B. Phillips, Assistant United States Attorney. Thereupon the following proceedings were had:

Counsel for plaintiff directed the attention of the Court to an agreed statement of facts signed by the parties and filed in the records of the cause. This stipulation appears elsewhere in the record, and is hereby made a part of this Bill.

AGREED STATEMENT OF FACTS.

IT IS HEREBY STIPULATED AND AGREED that the above entitled case may be tried by the court sitting without a jury. It is further stipulated and agreed by and between the parties hereto that the following facts are true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce further evidence not inconsistent with the facts herein stipulated, or as admitted in the pleadings.

I.

At all times herein mentioned plaintiff was and is a corporation organized and existing under and by virtue of the laws of the State of Maine, and having its principal office in the First United States Revenue District of California. That defendant now is and at all times since November 21, 1921, has been the duly appointed, qualified and acting Collector of United States Revenue for the First District of California, having his office in the City and County of San Francisco in the Southern Division of the Northern District of California, and is a citizen and resident of the State of California and of the Southern Division of the Northern District of California.

II.

During the year 1918, A. F. Thane & Company, a corporation organized and existing under and by virtue of the laws of the State of California, had an authorized capital stock of 1,000 shares of the par value of $100 each, of which 600 shares were issued and outstanding. The plaintiff Pacific Lumber Company owned 540 shares, which it had purchased from said A. F. Thane & Company at a cost of $31,500.00. A. F. Thane owned the remaining 60 shares. In 1920, the capital stock of A. F. Thane & Company was increased to 5,000 shares of the par value of $100 each. Pacific Lumber Company subscribed for 3960 additional shares, for which it paid $100 each, making its total holdings 4500

shares. A. F. Thane subscribed for additional stock, making his total holdings 500 shares. In 1921 Pacific Lumber Company purchased A. F. Thane's holdings and paid $52,125.00. The total sum paid by Pacific Lumber Company for the 5,000 shares of stock which it owned at the end of 1921 was $479,625.00.

III.

During the period between March 17, 1921, and the close of December, 1923, Pacific Lumber Company and A. F. Thane & Company had financial arrangements with each other by which Pacific Lumber Company from time to time advanced cash to A. F. Thane & Company, paid accounts for, and assumed indebtednesses of A. F. Thane & Company which it had guaranteed, the total sum of such cash advances, accounts paid and indebtednesses assumed amounting to $1,234,157.09. A. F. Thane & Company from time to time during this interval made partial repayments of said advances, accounts, etc., the total of which repayments at the close of December, 1923, amounted to $260,461.88. At the close of 1923 A. F. Thane & Company was duly dissolved by order and decree of the Superior Court of the City and County of San Francisco, State of California, and was liquidated by transfer of all of its remaining assets to Pacific Lumber Company and by closing its books and ceasing to do business. At the close of the year 1923 the assets thus transferred to Pacific Lumber Company consisted of

cash $1,240.67; furniture and fixtures valued on the books of A. T. Thane & Company at $9,682.23; accounts receivable valued on the books of A. F. Thane & Company at $2,731.73, notes receivable valued on the books of A. F. Thane & Company at $3,220.60; claims pending settlement valued on the books of A. F. Thane & Company at $3,685.49. The total value at which these assets were carried on A. F. Thane & Company's books and at which value they were taken over in liquidation by Pacific Lumber Company was $20,560.72. These assets, so valued, were applied by Pacific Lumber Company on its books to the advances, accounts paid and other indebtednesses of A. F. Thane & Company to Pacific Lumber Company.

The net amount due to Pacific Lumber Company from A. F. Thane & Company as a result of all the transactions enumerated hereinabove (Paragraph III) was $953,134.49. The Pacific Lumber Company left as an asset on its books the sum of $1 to reflect the value of its stock holdings in A. F. Thane & Company and the sum of $1 to reflect the value of the accounts receivable of A. F. Thane & Company. Pacific Lumber Company, plaintiff herein, at the close of 1923 charged off on its books the balance, to wit, $953,134.49, as a debt ascertained to be worthless during the tax year 1923.

IV.

During the years 1920, 1921, 1922 and 1923, the plaintiff the Pacific Lumber Company of Maine was

affiliated with A. F. Thane & Company and the Pacific Lumber Company, an Illinois corporation. Separate tax returns were filed by each of these companies and a consolidated return was filed, showing the operations of the three companies. Taxes were paid upon the net income shown in the consolidated returns. The separate and consolidated returns showed the following:

For the tax year 1920 Pacific Lumber Company of Maine, separate return, reported net income $2,-262,959.39; Pacific Lumber Company of Illinois separate return a loss amounting to $23,052.35; A. F. Thane & Company separate return net loss $443,-821.95; total net loss $466,874.30. The consolidated return of the three companies reported a net profit of $1,796.085.09 and taxes were paid upon this last amount.

For the tax year 1921, the Pacific Lumber Company of Maine, separate return, reported net income $379,624.88; Pacific Lumber Company of Illinois, separate return, reported net income $18,-314.97; A. F. Thane & Company, separate return, reported a net loss $548,166.82. The consolidated return of the three companies showed a net loss of $150,226.97 and no tax was paid.

For the tax year 1922 the Pacific Lumber Company of Maine upon its separate return showed a net income of $1,266,450.51. The Pacific Lumber Company of Illinois by its separate return showed a net income of $31,198.03; A. F. Thane & Company

by its separate return reported a net loss of $344,-791.49. The consolidated returns of the three companies showed a net income amounting to $952,-857.05. Upon the consolidated return the consolidated net loss for 1921, amounting to $150,226.97 was carried forward, as permitted by law, and the total net profit, upon which taxes were paid for the tax year 1922 was $802,630.08.

For the tax year 1923, the Pacific Lumber Company of Maine, separate return, showed a net income of $1,379,494.78. The separate return of the Pacific Lumber Company of Illinois showed a net income of $8,809.83. A. F. Thane & Company, separate return, showed a net loss of $229,942.15. The net income shown upon the consolidated return for the three companies for the tax year 1923 amounted to $1,138,362.46. Said consolidated return, with separate returns was filed on or about April 14, 1924. Upon said consolidated net income of $1,-158,362.46 the Pacific Lumber Company paid to the defendant the sum of $144,795.31 as the total income tax for the calendar year 1923, said amount being paid as follows:

March 20, 1924	$36,200.00
June 1, 1924	$36,198.44
Sept. 15, 1924	$36,198.44
Dec. 7, 1924	$36,198.43

Thereafter on or about April 30, 1928, upon an examination and an audit by the supervising Internal Revenue Agent at San Francisco, plaintiff's corrected net income for the year 1923 was found

to be $1,144,977.80 as taxable for said year 1923, and the amount of $143,122.23 was found to be the total amount of income tax due upon said corrected net income. Plaintiff received from defendant a refund in the amount of $1,673.08, with interest thereon, on account of the difference between the total income tax shown to be payable upon said corrected net income and the amount shown to be payable upon the original return. Said correction arose by reason of the supervising agent allowing the plaintiff a larger amount of depreciation upon certain of plaintiff's lumber properties than plaintiff had claimed in its original return.

The details of the foregoing facts are shown in the income tax returns for the several years in question.

V.

On or about March 14, 1928, plaintiff filed with defendant and thereafter defendant transmitted to the Commissioner of Internal Revenue, a claim for refund of said total amount of $143,122.23 of income tax theretofore paid, together with interest thereon in the sum of $37,645.90, or a total of $180,-[illegible]. Said claim was made pursuant to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof. Thereafter said claim for refund was rejected and disallowed by the Commissioner of Internal Revenue on or about June 14, 1928. No part of the aforesaid sum of $143,122.23 and no

part of the interest thereon has been refunded or repaid to plaintiff by defendant.

PILLSBURY, MADISON & SUTRO,
(Attorneys for Plaintiff)

GEO. J. HATFIELD,
ESTHER B. PHILLIPS,
(Attorneys for Defendant)

[Endorsed]: Filed February 19, 1931.

The following documents were also admitted in evidence:

Copy of the consolidated income and profits tax returns of plaintiff, Pacific Lumber Company of Maine, Pacific Lumber Company of Illinois, and A. F. Thane & Company for the year 1920 was marked Plaintiff's Exhibit "A" (1). [30]

The separate income tax returns for 1920 of said corporations were marked Plaintiff's Exhibit "A" (2), "A" (3) and "A" (4), respectively. All of these exhibits are attached to this Bill of Exceptions and are made a part hereof.

Copy of the consolidated income and excess profits tax return for the year 1921 of Plaintiff, the Pacific Lumber Company of Maine, Pacific Lumber Company of Illinois, and A. F. Thane & Company was marked Plaintiff's Exhibit "B" (1).

The separate income and profits tax returns for 1921 of said corporations were marked Plaintiff's Exhibits "B" (2), "B" (3) and "B" (4), respectively. Said exhibits are attached to this Bill of Exceptions and are made a part hereof.

Copy of the consolidated income tax return of plaintiff, Pacific Lumber Company of Maine, Pacific Lumber Company of Illinois and A. F. Thane & Company for 1922, was marked Plaintiff's Exhibit "C" (1).

The separate tax returns for said corporations for the year 1922 were marked Plaintiff's Exhibit "C" (2), "C" (3) and "C" (4), respectively. Said exhibits are attached to this Bill of Exceptions and are made a part hereof.

Copy of the consolidated tax return of plaintiff, Pacific Lumber Company of Maine, Pacific Lumber Company of Illinois and A. F. Thane & Company for 1923 was marked Plaintiff's Exhibit "D" (1). The separate income tax returns of said corporations were marked Plaintiff's Exhibit "D" (2), "D" (3) and "D" (4). Said exhibits are attached to this Bill of Exceptions and are made a part hereof. [31]

Whereupon plaintiff rested.

The defendant moved for a nonsuit. Said motion was taken under submission by the court. The defendant then directed attention to the stipulation of facts filed in the records of the case and rested.

Plaintiff moved for a judgment in plaintiff's favor as prayed in the complaint. Defendant moved for a judgment in defendant's favor as prayed in the answer.

Plaintiff's motion and the defendant's two motions were taken under submission by the court.

Thereafter, briefs were filed and the cause was taken under submission by the court.

On January 14, 1932, the court denied the defendant's motion for a nonsuit to which the defendant duly excepted, and said exception is hereby assigned as

Defendant's Exception No. 1.

The court granted the plaintiff's motion for judgment as prayed in the complaint to which the defendant excepted, the said exception being

Defendant's Exception No. 2.

The court denied the defendant's motion for judgment, to which the defendant excepted, said exception being

Defendant's Exception No. 3.

WHEREFORE, defendant, within the time required by law and the rules of court, presents this his Bill of Exceptions and prays that the same be settled, allowed and approved by the court.

GEO. J. HATFIELD,
United States Attorney,
ESTHER B. PHILLIPS,
Asst. United States Attorney,
Attorneys for Defendant. [32]

ORDER SETTLING AND ALLOWING BILL OF EXCEPTIONS.

The foregoing Bill of Exceptions containing all the evidence in the cause is correct in all respects and is hereby SETTLED and ALLOWED as the Defendant's Bill of Exceptions for use on appeal in the above-entitled action.

It is FURTHER ORDERED that the Stipulation of Facts and the Exhibits introduced in evidence upon the trial of said action may be withdrawn and when duly certified and authenticated by the Clerk of this Court, may be transferred to the Clerk for the United States Circuit Court of Appeals for the Ninth Circuit to become a part of the record on appeal, and when so transmitted to said United States Circuit Court of Appeals may be referred to by the parties hereto and by said Court as a part of said Bill of Exceptions.

Dated, San Francisco, Calif.,
January 29, 1932.

A. F. ST. SURE,
United States District Judge.

Service of the within.....by copy admitted this 18th day of Jan., 1932.

PILLSBURY, MADISON & SUTRO,
Attorneys for Plaintiff.

[Endorsed]: Filed Jan. 29, 1932. [33]

[Title of Court and Cause.]

PETITION FOR APPEAL AND ORDER ALLOWING APPEAL.

To the Honorable A. F. St. Sure, United States District Judge:

The defendant herein feeling aggrieved by the judgment entered in this case on or about the 14th day of January, 1932, does hereby appeal from said judgment to the Circuit Court of Appeals for the Ninth Circuit for the reasons set forth in the Assignment of Errors filed herewith, and prays that this appeal be allowed, that a citation be issued as provided by law, that a transcript of the record, proceedings and documents upon which said judgment was based, duly authenticated, be sent to the Clerk of said Circuit Court of Appeals under the rules of such court, and that no bond or other security be required of the defendant upon said appeal.

GEO. J. HATFIELD,
United States Attorney,
ESTHER B. PHILLIPS,
Asst. United States Attorney,
Attorneys for Defendant.

ORDERED that the appeal be allowed and that defendant shall not be required to give any bond or other security upon said appeal.

A. F. ST. SURE,
United States District Judge.

Service of the within Petition, etc., by copy admitted this 4th day of April, 1932.

PILLSBURY, MADISON & SUTRO,
Attorneys for Plaintiff.

[Endorsed]: Filed Apr. 4, 1932. [34]

[Title of Court and Cause.]

ASSIGNMENT OF ERRORS.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes the defendant, John P. McLaughlin, United States Collector of Internal Revenue for the First Collection District of California, and files the following Assignment of Errors upon which he will rely in his petition for review of the judgment entered by the above-entitled court in this cause on or about the 14th day of January, 1932.

I.

The court erred in rendering and entering its decision and judgment in favor of plaintiff and against the defendant.

II.

The court erred in rendering and entering a judgment in favor of plaintiff in the whole amount prayed for in the complaint ($143,122.23) and in determining that a refund in said amount was due to plaintiff on account of an over-payment of taxes by plaintiff for the tax year 1923.

III.

The court erred in granting plaintiff's motion for judgment in its favor as prayed in the complaint.

IV.

The court erred in denying defendant's motion for a [35] nonsuit.

V.

The court erred in denying defendant's motion for a judgment in his favor.

VI.

The court erred in holding and determining that following the dissolution and liquidation of A. F. Thane & Company at the close of 1923, and the taking over of its remaining assets by the plaintiff, Pacific Lumber Company, the plaintiff was entitled to a deduction from its gross income for the year 1923, as a loss ascertained during the said year, in the entire amount of its investment in the stock of A. F. Thane & Company, to-wit, $474,625.00, and was further entitled to a deduction from its gross income for said year, as a loss ascertained during said year, the sum of $953,134.49, on account of advances made to said A. F. Thane & Company.

VII.

The court erred in holding and determining that following the dissolution and liquidation of A. F. Thane & Company, at the close of 1923, and the

taking over of its remaining assets by the plaintiff, Pacific Lumber Company, the plaintiff was entitled to take as a deductible loss ascertained during the year 1923 losses upon the liquidation of A. F. Thane & Company amounting to $474,625.00 and $953,-134.49, without offsetting against either of said losses upon said liquidation the loss amounting to $229,942.15 sustained by A. F. Thane & Company during the year 1923, of which loss plaintiff received the benefit in the consolidated return filed by plaintiff for said year 1923 and upon which plaintiff paid the tax shown.

VIII.

The court erred in holding and determining that following the dissolution and liquidation of A. F. Thane & Company at the close of 1923, and the taking over of its remaining assets by the plaintiff, the plaintiff was entitled to take as deductible losses ascertained during the year 1923 a loss of [36] $474,625.00 and a loss of $953,134.49, without offsetting against said sums, or either of them, the losses sustained by said A. F. Thane & Company during the years 1920, 1921 and 1922, amounting to $443,821.95, $548,166.82 and $344,791.49, respectively, of which losses plaintiff received the benefit in the consolidated returns filed by plaintiff for said years 1920, 1921 and 1922 and upon which taxes were paid as shown upon said returns.

WHEREFORE defendant prays that the judgment of the District Court be reversed and that

judgment be entered in favor of defendant, and that said cause be remanded to the District Court with instructions to enter such judgment in favor of defendant herein, or to enter such other judgment in said cause as in the opinion of the United States Circuit Court of Appeals for the Ninth Circuit is deemed meet and proper.

GEO. J. HATFIELD,
United States Attorney,
ESTHER B. PHILLIPS,
Asst. United States Attorney,
Attorneys for Defendant.

Service of the within assignment of errors by copy admitted this 4th day of April, 1932.

PILLSBURY, MADISON & SUTRO,
Attorneys for Plaintiff.

[Endorsed]: Filed Apr. 4, 1932. [37]

[Title of Court and Cause.]

NOTICE OF APPEAL.

To Plaintiff above-named, and to Messrs. Pillsbury, Madison & Sutro, its attorneys:

Please take notice that the defendant hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the judgment entered in this cause on or about January 14, 1932.

Dated, April 4, 1932.

GEO. J. HATFIELD,
United States Attorney,
ESTHER B. PHILLIPS,
Asst. United States Attorney,
Attorneys for Defendant.

Service of the within Notice of Appeal by copy admitted this 4th day of April, 1932.

PILLSBURY, MADISON & SUTRO,
Attorneys for Plaintiff.

[Endorsed]: Filed Apr. 4, 1932. [38]

[Title of Court and Cause.]

PRAECIPE.
(FOR RECORD ON APPEAL.)

To the Clerk of said Court:

Sir:

Please prepare and transmit to the Clerk of the United States District Court of Appeals for the Ninth Circuit, a transcript of the record in the above-entitled case for the use of said Circuit Court of Appeals, by including the following:

The Judgment Roll.
Stipulation Waiving Trial by Jury.
Stipulation of Facts.
Bill of Exceptions.
Opinion of the Court.
Assignment of Errors.
Petition and Order Allowing Appeal.
Notice of Appeal.
This Praecipe.

GEO. J. HATFIELD,
United States Attorney,
ESTHER B. PHILLIPS,
Asst. United States Attorney,
Attorneys for Defendant.

Service of the within Praecipe by copy admitted this 4th day of April, 1932.

PILLSBURY, MADISON & SUTRO,
Attorneys for Plaintiff.

[Endorsed]: Filed Apr. 4, 1932. [39]

[Title of Court and Cause.]

CERTIFICATE OF CLERK, U. S. DISTRICT COURT TO TRANSCRIPT OF RECORD.

I, Walter B. Maling, Clerk of the District Court of the United States, in and for the Northern District of California, do hereby certify the foregoing 39 pages, numbered from 1 to 39 inclusive, to be a full, true and correct copy of the record and proceedings as enumerated in the praecipe for record on appeal, as the same remain on file and of record in the above-entitled suit, in the office of the Clerk of said court, and that the same constitutes the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the cost of the foregoing transcript of record is $6.80; that said amount has been charged against the United States and the original Citation issued in said suit is hereby annexed.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of said District Court this 12 day of April, A. D. 1932.

[Seal] WALTER B. MALING,
Clerk United States District Court for the North ern District of California.

By B. E. O'Hara,
Deputy Clerk. [40]

[Title of Court and Cause.]

CITATION ON APPEAL.

United States of America.—ss.

The President of the United States of America
To Pacific Lumber Company, a corporation, Greeting:

YOU ARE HEREBY CITED AND ADMONISHED to be and appear at a United States Circuit Court of Appeals for the Ninth Circuit, to be holden at the City of San Francisco, in the State of California, within thirty days from the date hereof, pursuant to an order allowing an appeal, of record in the Clerk's Office of the United States District Court for the Northern District of California wherein JOHN P. McLAUGHLIN, Collector of Internal Revenue, is appellant, and you are appellee, to show cause, if any there be, why the decree or judgment rendered against the said appellant, as in the said order allowing appeal mentioned, should not be corrected, and why speedy justice should not be done to the parties in that behalf.

WITNESS, the Honorable A. F. St. Sure, United States District Judge for the Northern District of California this 4th day of April, A. D. 1932.

A. F. ST. SURE,
United States District Judge.

Service of the within Citation by copy admitted this 4 day of April, 1932.

PILLSBURY, MADISON & SUTRO,
Attorneys for Plaintiff.

[Endorsed]: Filed Apr. 4, 1932. Walter B. Maling, Clerk. By B. E. O'Hara, Deputy Clerk. [41]

[Endorsed]: No. 6816. United States Circuit Court of Appeals for the Ninth Circuit. John J. McLaughlin, Collector of Internal Revenue for the First District of California, Appellant, vs. Pacific Lumber Company, a Corporation, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division. Filed April 12, 1932.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

JOHN P. MCLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

Proceedings had in the United States Circuit Court of Appeals for the Ninth Circuit.

At a stated term, to wit: The October term, A.D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the city and county of San Francisco, in the State of California, on Monday the thirtieth day of January, in the year of our Lord one thousand nine hundred and thirty-three.

Present: Honorable Curtis D. Wilbur, Senior Circuit Judge, presiding; Honorable William H. Sawtelle, Circuit Judge; Honorable Frank H. Norcross, District Judge.

No. 6816

JOHN P. MCLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Order of submission

Ordered above cause argued by Miss Esther B. Phillips, assistant United States attorney, counsel for appellant, and by Mr. Felix T. Smith, counsel for appellee, and submitted to the court for consideration and decision.

At a stated term, to wit: The October term, A.D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the city and county of San Francisco, in the State of California, on Wednesday the sixth day of September in the year of our Lord one thousand nine hundred and thirty-three.

Present: Honorable Curtis D. Wilbur, Senior Circuit Judge, presiding; Honorable William H. Sawtelle, Circuit Judge.

No. 6816

JOHN P. McLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Order directing filing of opinion and filing and recording of judgment

By direction of the court, ordered that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion filed.

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 6816. Sept. 6, 1933.

JOHN P. McLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Before: WILBUR and SAWTELLE, Circuit Judges, and NORCROSS, District Judge.

SAWTELLE, *Circuit Judge:*

From a judgment rendered by the District Court in favor of the Pacific Lumber Company, plaintiff below, for recovery of income taxes paid to the collector of internal revenue, the latter appeals. The judgment was for $143,122.23, representing income taxes paid by the appellant for the year 1923. Interest on that sum at the rate of six percent to January 13, 1932, totaling $64,977.53, and interest on the two foregoing sums from January 13, 1932, until paid, also at six percent, were allowed by the lower court. The date of January 13, 1932, was the one on which the judgment of the District Court was rendered. The case was tried before the court, without a jury, on an agreed statement of facts, together with the income tax returns referred to in the stipulation.

The appellee is a Maine corporation, with its principal office in California. During the years 1920, 1921, 1922, and 1923 it was affiliated with two subsidiary corporations, the Pacific Lumber Com-

pany of Illinois and A. F. Thane & Company of California. During those years the operations of the three affiliates showed the following: The Thane Company suffered heavy loss each year; the Illinois Company showed a loss in 1920 and profits in 1921, 1922, and 1923; and the Maine Company, or parent concern, made substantial profits each year.

According to the agreed statement of facts, "separate tax returns were filed by each of these companies and a consolidated return was also filed, showing the operations" of the three corporations. "Taxes were paid upon the net income shown in the consolidated returns." In his brief, the appellant states, and, we believe, correctly, that, though each company filed a separate return, no tax was computed thereon.

By the end of 1921 the appellee was the owner of the entire 5,000 shares of stock in the Thane Company, at a total cost of $479,625.

During 1923 the Thane Company liquidated its business and assets, at a total loss of $106,915.01. The remaining assets were valued on its books at $20,560,72, and were taken over by the appellee at the same figure, as a final distribution in liquidation to it as sole stockholder at the time of dissolution. The assets transferred at the book value of $20,560.72 to the parent company were applied by the latter to reduce the amount owing to it by its dissolved subsidiary to the final figure of $953,134.49.

The cost of the stock of the Thane Company to the appellee, or parent company, was, as we have seen, $479,625, and the indebtedness remaining due to the appellee, after final distribution to it was $953,134.49. The appellee did not at the time of filing the separate or consolidated tax returns for 1923 claim either of the sums just mentioned, as deductions, but now asserts the right to deduct them in the consolidated tax return of the affiliated companies as losses that occurred in 1923.

It is with the 1923 tax liability that the present case is concerned. The separate and consolidated returns for that year showed the net income of the affiliated companies to be $1,158,362.46, which was reduced by the Bureau to $1,144,977.80. The tax on this latter amount was $143,122.23, and was regularly paid during 1924 in quarterly installments.

In March 1928 the appellee filed a claim for refund of the entire tax thus paid, with interest, upon the theory that it had suffered losses during 1923 amounting to $1,432,759.49, which it failed to deduct from the gross income reported on its separate return. If losses in this amount are deductible for 1923, the net income reported would be turned into a deficit, and the consolidated net income of $1,144,977.80 would be wiped out, no tax at all being payable.

The losses of $1,432,759.49 that the appellee claims that it should have deducted consist of the purchase price of the Thane stock,

$479,625, and the balance owing to the appellee from the Thane Company at the end of 1923, or $953,134.49.

The appellant's principal contentions are:

1. That the losses of a parent corporation in connection with the liquidation and dissolution of a wholly owned subsidiary corporation are not allowable deductions for income-tax purposes in a year for which a consolidated return has been filed, which includes the subsidiary's activities up to the date of the latter's dissolution.

2. If the losses of the parent in this case upon the liquidation and dissolution of its subsidiary in 1923 are to be construed for tax purposes as its own losses, and not the result of intercompany transactions, the facts show that these losses were fully and effectively recovered by the appellee for tax purposes by deductions taken in the consolidated returns for 1920 to 1923, inclusive, for the operating losses of the subsidiary.

As to the first contention, however, the appellant makes the following concession in his brief:

"It would be idle for us to deny that upon the broad question whether a parent company may deduct a loss of investment on the liquidation of a subsidiary, the present trend of decisions, both in the Board of Tax Appeals and in the courts, is in favor of the taxpayer."

Accordingly, we will devote our discussion principally to the appellant's second proposition.

After the appellant's brief was filed in this court, the case of *Burnet* v. *Aluminum Goods Co.* (287 U.S. 544), was decided by the Supreme Court. As was indicated in the appellant's brief, the decision of the Supreme Court has clarified the whole subject.

In order to appreciate the parallelism between the facts in the Aluminum case and those at bar, it will be helpful to quote the statement of the Supreme Court, at pages 545, 546:

"In 1914 respondent, a New Jersey manufacturing corporation, purchased all the capital stock of the Aluminum Sales and Manufacturing Company, a New York corporation. From that time until its liquidation, carried on in 1917, the Sales Company was principally engaged in selling goods manufactured by the respondent. In February 1918 is was dissolved. The operation of the Sales Company reflected net losses during the years 1914, 1915, and 1916, as well as in the year 1917. As a result of the operating losses and the liquidation of the Sales Company, respondent suffered the loss of certain sums advanced to the Sales Company, and of the total investment in its stock.

"For 1917 the two corporations filed separate returns for computation of the normal income tax, and a consolidated return for the purpose of the excess-profits tax. In its separate return respondent claimed, and the Commissioner allowed, deduction of an aggregate loss made up of respondent's advances to the Sales Company, and the cost of its stock, less the value of equipment and goodwill realized on its liquidation. This loss, reduced by the 1917 operating loss

of the Sales Company, was deducted from gross income in the consolidated return. The Commissioner's refusal to allow the deduction was sustained by the Board of Tax Appeals (22 B.T.A. 1), whose determination was reversed by the Circuit Court of Appeals for the Seventh Circuit (56 F. (2d) 568)."

Upon the foregoing state of facts, the Supreme Court said:

"The purpose of requiring consolidated returns by affiliated corporations was, as the Government contends, to impose the war-profits tax, according to true net income and invested capital of what was, in practical effect, a single business enterprise, even though conducted by means of more than one corporation. Primarily, the consolidated return was to preclude reduction of the total tax payable by the business, viewed as a unit, by redistribution of income or capital among the component corporations by means of intercompany transactions. * * *

"In the present case, even though the affiliation continued, it does not follow as a matter of law that the loss was not rightly deducted in the consolidated return. [Statutes and a Treasury Regulation summarized]. It is conceded that the loss of respondent's advances to the Sales Company and the investment in its stock was sustained in 1917, was deductible therefore, if at all, in that year, and might properly have been deducted by respondent in a separate return, if a separate return had been permissible. But the Government insists that the loss cannot be deducted in the mandatory consolidated return for 1917 because it occurred as the result of 'intercompany' transactions.

"We need not decide whether the loss resulted from intercompany transactions within the meaning of the regulations under later statutes which broadly exclude from the consolidated returns profit or loss upon all such transactions. For neither the Revenue Act of 1917, nor §1331 of the Revenue Act of 1921, nor the regulations under them, prescribe specifically the method of making up the consolidated return *or require the elimination from the computation of the tax of the results of all intercompany transactions.*" (Italics our own.) (Pages 547–549.)

At this juncture it may be remarked that though the Revenue Act of 1917 is not involved in the present case, sections of the Revenue Act of 1921 are quoted as pertinent in the appellant's brief.

It is likewise observable that, in a footnote to the text just quoted, the Supreme Court cites, at page 549, article 636 of Treasury Regulations 65, under the Revenue Act of 1924. The pertinent language of that article is identical with that of article 636 of Treasury Regulations 62, under the Revenue Act of 1921, which is relied upon by the appellant herein. The language of article 636 in each set of regulations is as follows:

"Subject to the provisions covering the determination of taxable net income of separate corporations, *and subject further to the elimination of intercompany transactions* (whether or not resulting in any profit or loss to the separate corporations), the consolidated

taxable net income shall be the combined net income of the several corporations consolidated. * * *"

It is clear that the Supreme Court did not regard these provisions as barring the taxpayer's right to deduct losses resulting from *every* intercompany transaction, for the court continued:

"These provisions plainly do not lay down any rigid rule of accounting to be applied to consolidated returns which would exclude from the computation of taxable income the results of every intercompany transaction, regardless of its effect upon the capital or the net gains or losses of the business of the affiliated corporations. Instead, they merely disclose the purpose underlying regulations and statute to prevent, through the exercise of a common power of control any intercompany manipulations which would distort invested capital or the true income of the unitary business carried on by the affiliated corporations. Hence, no method of accounting, in calculating taxable income upon the consolidated return, can be upheld, which would withhold from the taxpayer all benefit of deduction for losses actually sustained and deductible under the sections governing the computation of taxable income, and which at the same time would not further, in some way, the very purpose for which consolidated returns are required.

"Such we think is the effect of the method adopted by the Commissioner."

From the foregoing language of the Supreme Court, it is clear that the question of "intercompany transaction" vel non is not the decisive one in the instant case, despite the space devoted to it in the briefs. A different test is the one indicated by the Supreme Court, namely, the *effect* of the intercompany transaction "upon the capital or the net gains or losses of the business of the affiliated corporations", and whether or not any proposed calculation of taxable income upon the consolidated return "would withhold from the taxpayer all benefit of deduction for losses actually sustained and deductible under the sections governing the computation of taxable income", etc.

This same broad test is again laid down by the Supreme Court in the closing paragraph of the opinion in the Aluminum case:

"The loss was a real one, suffered by respondent as a separate corporate entity, and it was equally a loss suffered by the single business carried on by the two corporations during the period of their affiliation, ultimately reflected in the 1917 loss of capital invested in that business. While equitable principles of accounting applied to the calculation of the net income of the business unit do not permit deduction of the loss twice, they do require its deduction once. Hence, the loss was deductible in 1917 under the statute and regulations controlling computation of taxable income, and its deduction is not forbidden by the regulations applicable to the consolidated return. Article 77 and 78 of Treasury Regulations 41 would, indeed, require the elimination of any losses resulting from intercompany transactions the inclusion of which would defeat the purpose of

consolidated returns to tax the true income of the single business of affiliated corporations, calculated by correct accounting methods. The deductions claimed here had no such effect."

The foregoing interpretation of the Aluminum case is supported by the language used by the Supreme Court in *Atlantic City Co.* v. *Commissioner*, 288 U.S. 152, 154, decided on February 6, 1933:

"The purpose of the Congress was to secure substantial equality among stockholders who ultimately bear the burden of taxation and to prevent evasion through the manipulation of intercompany transactions. [Authorities, including the Aluminum case, cited.] The requirement of consolidated returns was 'based upon the principle of levying the tax according to the true net income and invested capital of a single business interprise, even though the business is operated through more than one corporation.' Treasury Regulations No. 45, art. 631."

Applying the doctrine of the Aluminum case to the facts at bar, after an examination of the record and of the exhibits, we do not find that there is evidence to sustain the appellant's allegation of double deduction. The appellant has failed to establish any specific instance of such deduction. Mere similarity of totals as between different years does not justify the inference that the deduction is a double one. In the words of the Supreme Court, "the deductions claimed here had no such effect."

On the other hand, we believe that the appelle has established its right to the deductions, and that it is entitled to the refund in question.

The matter of interest on the amount claimed as a refund is also in controversy here. As we have already seen, interest was allowed at six percent from the dates of payment to the date of the rendering of the judgment, thereafter on the whole amount at six percent until paid. In opposition to this rate of interest, the appellant cites section 319 of the Act of June 30, 1932 [28 U.S. C.A. 811 (a),], in which the rate of interest in a case of this kind is fixed at four percent.

As the appellee points out, however, on January 30, 1933, the day on which the instant case was argued before this court, the President of the United States signed the deficiency appropriation bill (H.R. 14436, Public No. 325, 72d Congress), pages 7–8, section 2 of which provides in part as follows:

" * * *

"Section 319 of the Act of June 30, 1932 (Economy Act) (47 Stat. 412), shall not apply to any judgment rendered against the United States prior to July 1, 1932. Appropriations for the payment of any such judgment and interest thereon shall be available for the payment of principal and interest in accordance with the terms of such judgment and the appropriation therefor, notwithstanding the provisions of sections 319 and 803 of such act."

See also section 14 of title II, Public No. 428, 72d Congress, page 31, approved March 3, 1933.

Since the "judgment as to interest" in the present case was dated before July 1, 1932, that is, on January 18, 1932, the foregoing section is applicable, and the rate of six percent must be upheld.

Accordingly the judgment is affirmed.

(Endorsed:) Opinion. Filed Sep. 6, 1933. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 6816

JOHN P. MCLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Judgment

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of California, Southern Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this court, that the judgment of the said District Court in this cause be, and hereby is affirmed.

(Endorsed:) Judgment. Filed and entered September 6, 1933. Paul P. O'Brien, clerk.

At a stated term, to wit: The October term, A.D. 1933, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the city and county of San Francisco, in the State of California, on Friday the twenty-third day of February in the year of our Lord one thousand nine hundred and thirty-four.

Present: Honorable Curtis D. Wilbur, senior circuit judge, presiding; Honorable William H. Sawtelle, circuit judge; Honorable Francis A. Garrecht, circuit judge.

No. 6816

JOHN P. MCLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Order denying petition for a rehearing

Upon consideration of the petition of appellant, filed October 4, 1933, for a rehearing of above cause, and of the reply of appellee

thereto, filed October 12, 1934, and good cause therefor appearing, and by direction of the court, it is ordered that the said petition for rehearing be, and hereby is, denied.

(In the United States Circuit Court of Appeals for the Ninth Circuit)

(Endorsed:) Filed May 1, 1934. Paul P. O'Brien, clerk.

No. 6816

JOHN P. MCLAUGHLIN, COLLECTOR FOR THE FIRST DISTRICT OF CALIFORNIA, appellant

v.

PACIFIC LUMBER COMPANY, APPELLEE

Motion

Comes now John P. McLaughlin, appellant above named, by the United States attorney, his counsel, and respectfully requests that the court recall the mandate issued to the District Court for the Northern District of California on March 3, 1934.

In support of this motion the appellant respectfully states: That the appellant has this day filed his petition for a rehearing and reconsideration of this cause to which reference is hereby respectfully made.

Wherefore, the appellant respectfully prays that this motion be granted.

Dated: April 30, 1934.

H. H. MCPIKE,
United States Attorney, Attorney for Appellant.
By ESTHER B. PHILLIPS,
Assistant United States Attorney.

(Endorsed:) Motion to recall mandate. Filed May 1, 1934. Paul P. O'Brien, clerk.

In the United States Circuit Court of Appeals for the Ninth Circuit

(Endorsed:) Filed May 1, 1934. Paul P. O'Brien, clerk.

No. 6816

JOHN P. MCLAUGHLIN, COLLECTOR FOR THE FIRST DISTRICT OF CALIFORNIA, appellant

v.

PACIFIC LUMBER COMPANY, APPELLEE

Motion

Comes now John P. McLaughlin, collector for the first district of California, appellant, by the United States attorney, his counsel,

and respectfully requests that the court grant leave to file the attached petition for a rehearing and reconsideration of this cause, and in support of this motion the appellant shows unto the court:

That the petition for rehearing heretofore filed in this cause was denied by this honorable court on February 23, 1934; that subsequent to the denial of the petition for rehearing, and on April 2, 1934, the United States Supreme Court handed down its opinion in the case of *Charles Ilfeld Co.* v. *Hernandez, collector*, not yet reported, but found in 343 C.C.H., p. 9714; and that the decision in that case requires a reversal of the decision of this court in the instant case.

Wherefore the appellant respectfully prays that this motion be granted.

H. H. McPike,
United States Attorney.

(Endorsed:) Motion for leave to file second petition for rehearing. Filed May 1, 1934. Paul P. O'Brien, clerk.

Petition for rehearing and reconsideration

To the Honorable Judges of the Circuit Court of Appeals for the Ninth Circuit:

John P. McLaughlin, Collector for the First District of California, appellant, by his counsel, the United States attorney, respectfully requests that this court grant a rehearing in this cause and reconsider its opinion and judgment heretofore filed and entered herein for the following reasons:

On April 2, 1934, the United States Supreme Court handed down its opinion in *Charles Ilfeld Co.* v. *Hernandez, Collector*, on writ of certiorari to the Circuit Court of Appeals for the Tenth Circuit, wherein the decision of the Tenth Circuit Court of Appeals was affirmed. In that case the Supreme Court, sustaining the decision below, held that no deduction could be allowed to the taxpayers for losses sustained in respect of its investment in the stock of and advances to subsidiary corporations in the year of liquidation of the subsidiaries, whereon consolidated returns of income of the affiliated corporations for prior taxable years the taxpayer had been allowed deductions from its otherwise taxable income for operating losses sustained by the subsidiaries, the aggregate of such operating losses allowed as deductions upon the consolidated returns for the prior years being in excess of the total stock investment and advances by the taxpayer to the subsidiaries. The decision of the Supreme Court is predicated upon two grounds, (1) that the loss of stock investment and advances resulting from the liquidation was sustained during a consolidated return period in an intercompany transaction, which under the express provisions of the regulations there applicable was not an allowable deduction; (2) that to allow the loss of the stock investment and advances as a deduction in the year of liquidation of the subsidiaries, where the taxpayer had obtained the benefit by deductions from its income

in prior years for losses sustained by the subsidiaries through the medium of consolidated returns would be the practical equivalent of a double deduction which, in the absence of a provision of the statute, could not be allowed.

The first ground of the decision in the *Ilfeld* case is not applicable in the instant case. The taxable year there involved was 1929 which is governed by section 141 of the Revenue Act of 1928 and Treasury Regulations 75, promulgated under that section. The taxable year here involved is 1923, which is governed by section 240 of the Revenue Act of 1921 and articles 631 and 636 of Treasury Regulations 62. Section 141 of the Revenue Act of 1928 authorizes the filing of consolidated returns by affiliated corporations for the taxable year 1929 and subsequent years, expressly upon condition that all the corporations affiliated consent to regulations prescribed by the Commissioner with respect to such returns and further directs the Commissioner to promulgate the necessary regulations. Regulations 75, promulgated pursuant to this direction, prescribe in detail the procedure to be followed in the computation of consolidated net income and the taxes thereon. The applicable statutory provisions and regulations for the taxable year 1928 and prior years do not particularize in detail the rules for treatment of the many complex problems presented in the determination of the consolidated net income and the correct tax liability of affiliated corporations filing consolidated returns.

The second ground of the decision in the *Ilfeld* case, however, is directly applicable to the instant case and, we respectfully submit, requires a revision of the opinion of this court and a reversal of the judgment heretofore entered herein. The facts in the instant case present a striking parallel to those involved in the *Ilfeld* case. In the *Ilfeld* case the taxpayer claimed and was allowed deductions upon consolidated returns in the years prior to 1929 for operating losses sustained by its affiliated corporations in the aggregate amount of $190,431.66. In 1929 the affiliated corporations were dissolved, at which time the taxpayer had an aggregate investment in stock and advances to the subsidiaries of $168,812.49. Upon the liquidation and dissolution of its affiliated corporations the taxpayer took over the net balance of each subsidiary's assets after the payment of debts to others, such balances aggregating $38,020.38. Upon the return for the year 1929 the taxpayer claimed a deduction for the loss of the unpaid balance of its investment in stock and advances to the affiliates amounting to $130,792.11. The situation there obtaining was graphically set forth by the Supreme Court in a footnote to its opinion as follows:

	Springer Co.	Roy Co.	Combined
Operating losses claimed and deducted prior to 1929	$131,424.41	$59,007.25	$190,431.66
Investment loss claimed for 1929	86,116.05	44,676.06	130,792.11
Total losses claimed	217,540.46	103,683.31	321,223.77
Investment (stock plus advances)	109,030.27	59,782.22	168,812.49

In denying the taxpayer's claim to the deduction in 1929 of the net balance of its investment in stock and advances to the affiliated corporations the Supreme Court said:

"The allowance claimed would permit petitioner twice to use the subsidiaries' losses for the reduction of its taxable income. By means of the consolidated returns in earlier years it was enabled to deduct them. *And now it claims for 1929 deductions for diminution of assets resulting from the same losses. If allowed, this would be the practical equivalent of double deduction.* In the absence of a provision of the Act definitely requiring it, a purpose so opposed to precedent and equality of treatment of taxpayers will not be attributed to lawmakers." (Italics supplied.) * * *.

In the instant case the record shows (R. 25–27) that during the years 1920 to 1923, inclusive, the appellee was affiliated with A. F. Thane and Company and the Pacific Lumber Company of Illinois, and that for each of said years a consolidated return, as well as separate returns, were filed. Taxes were paid upon the net income shown in the consolidated returns. The net income or loss of the affiliated corporations, and the consolidated net income or loss, for each of the years 1920 to 1923, were as follows:

	1920	1921	1922	1923
Pac. Lbr. Co. of Mo., appellee	$2,262,959.39	$379,624.88	$1,266,450.51	$1,379,444.78
A. F. Thane Co.	[1] 443,821.95	[1] 548,166.82	[1] 344,791.49	[1] 229,942.15
Pac. Lbr. Co. of Ill.	[1] 23,052.35	18,314.97	31,198.03	8,809.83
Consolidated	1,796,085.09	[1] 150,226.97	952,857.05	1,138,362.46

[1] Net loss.

The consolidated net loss of $150,226.97 for 1921 was allowed as a deduction from the consolidated net income for 1922, resulting in a consolidated net income for the latter year of $802,630.08, upon which the tax was paid.

From the foregoing tabulations, it will be seen that during the years 1920 to 1923, inclusive, the appellee was permitted to deduct from its income, upon consolidated returns, the losses sustained by its affiliate, A. F. Thane and Company, in the aggregate amount of $1,566,722.41. The total investment of the appellee in the stock of the Thane Company was $479,625 and the net unpaid balance of advances at the end of 1923 to the Thane Company was $953,134.49, resulting in an aggregate investment in stock and advances of $1,432,759.49. The latter amount was claimed by the appellee as a deduction in the year 1923. These significant facts may be otherwise shown in the manner adopted by the Supreme Court in the *Ilfeld* case:

Operating losses of affiliate claims and deducted by appellee 1920 to 1923, inclusive	$1,566,722.41
Investment loss claimed by appellee for 1923	1,432,759.49
Total losses claimed by appellee	2,999,481.90
Investment (stock plus advances)	1,713,782.09

This court, affirming the judgment of the District Court, held that the deduction of 1923 should be allowed. In the language of the Supreme Court the allowance of the deduction in 1923 permits the appellee to twice use the subsidiary's losses for the reduction of its

taxable income and is the practical equivalent of a double deduction, for which there is no statutory authority.

We desire also to point out that in *Burnet* v. *Aluminum Goods Co.*, 287 U.S. 544, upon which this court relied in affirming the judgment of the district court for the appellee, the taxpayer did not, and could not, obtain the benefit of the subsidiary's losses in the years prior to the taxable year there involved (1917). Affiliation of corporations for tax purposes was neither required nor permitted prior to 1917. Each corporation made its separate return of net income and was taxed thereon without regard to its relationship to other corporations. Hence the operating losses of the subsidiary in the years prior to 1917 were not avaliable to the taxpayer as deductions from its income in those years. That situation prompted the observation of the Supreme Court that the stock investment and advances were a real loss in 1917 when the subsidiary was liquidated. It must be noted, however, that the taxpayer there was allowed a deduction in 1917, when a consolidated return for excess-profits tax purposes was filed, for the 1917 operating loss of the subsidiary and the amount of such loss was deducted from the total investment balance in fixing the amount of the investment loss which the Supreme Court said should be allowed as a deduction in 1917. The instant case and the *Ilfeld* case differ from the *Aluminum Goods Co.* case in that during the years preceding the taxable year involved in each of the former cases the affiliated corporations were required or permitted to file, and did file, consolidated returns of net income for tax purposes and the taxpayer in each instance claimed and deducted from its income in such prior years the losses of the subsidiary.

In view of the decision of the Supreme Court in the *Ilfeld* case it is thought that this court might desire to reconsider its opinion and judgment in the instant case. In that belief and to that end this petition is respectfully submitted.

Wherefore your petitioner, the appellant in this cause, respectfully prays that this petition may be granted; that the judgment heretofore entered herein may be vacated; that the opinion heretofore filed may be revised and the judgment of the District Court reversed.

Dated: This 30th day of April 1934.

H. H. McPike,
United States Attorney.
By Esther B. Phillip,
Assistant United States Attorney.

(Endorsed:) Second petition for rehearing. Lodged May 1, 1934. Paul P. O'Brien, clerk.

At a stated term, to wit: The October term, A.D. 1933, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the court room thereof, in the city and county of San Francisco,

in the State of California, on Monday the seventh day of May in the year of our Lord one thousand nine hundred and thirty-four.

Present: Honorable Curtis D. Wilbur, Senior Circuit Judge, presiding; Honorable Francis A. Garrecht, Circuit Judge.

No. 6816

JOHN P. McLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Order denying motions to recall mandate and file second petition for rehearing

Ordered motion of appellant to recall mandate of this court in above cause, heretofore issued on March 3, 1934, and motion of appellant for leave to file second petition for rehearing presented by Miss Esther B. Phillips, assistant United States attorney, counsel for appellant, and in support of said motions, and by Mr. Felix T. Smith, counsel for appellee, and in opposition to said motions, and submitted for consideration and decision.

Further ordered, after consideration, that said motions, and each of them be, and hereby is, denied.

United States Circuit Court of Appeals for the Ninth Circuit

No. 6816

JOHN P. McLAUGHLIN, COLLECTOR OF INTERNAL REVENUE FOR THE First District of California, appellant

vs.

PACIFIC LUMBER COMPANY, A CORPORATION, APPELLEE

Certificate of clerk, U.S. Circuit Court of Appeals for the Ninth Circuit to record certified under rule 38 of the Revised Rules of the Supreme Court of the United States.

I, Paul P. O'Brien, as clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing seventy-eight (78) pages, numbered from and including 1 to and including 78, to be a full, true, and correct copy of the entire record, excluding original exhibits, of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of Mr. A. Crawford Biggs, Solicitor General of the United States, on behalf of respondent, and certified under rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said United States Circuit Court of Appeals for the Ninth Circuit, at the city of San

Francisco, in the State of California, this 21st day of May, A.D. 1934.

[SEAL] PAUL P. O'BRIEN, *clerk.*

In the Supreme Court of the United States

October term, 1933

JOHN P. McLAUGHLIN, COLLECTOR OF INTERNAL REVENUE

v.

PACIFIC LUMBER COMPANY (A CORPORATION)

Order extending time within which to apply for a writ of certiorari

On consideration of the motion of counsel for the petitioner in the above-entitled cause, and good cause therefor having been shown, it is now here ordered that the time within which a petition for a writ of certiorari may be filed herein be, and the same hereby is, extended for a period of thirty days from May 23, 1934.

Dated this fifteenth day of May 1934.

GEORGE SUTHERLAND,

Associate Justice of the Supreme Court of the United States.

U. S. GOVERNMENT PRINTING OFFICE: 1934

Order allowing certiorari

Filed October 8, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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PETITION FOR A WRIT OF CERTIORARI

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and regulations involved	2
Statement	3
Specification of errors to be urged	5
Reasons for granting the writ	6
Appendix	10

CITATIONS

Case:	
Charles Ilfeld Co. v. *Hernandez*, No. 579, October Term, 1933, decided April 2, 1934	7, 8, 9
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat. 227, 254, 260:	
Sec. 234	10
Sec. 240	10
Miscellaneous:	
Treasury Regulations 62:	
Art. 631	11
Art. 636	11

67534—34

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. ——

JOHN P. MCLAUGHLIN, COLLECTOR OF INTERNAL REVENUE for the First District of California, petitioner

v.

PACIFIC LUMBER COMPANY, A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of John P. McLaughlin, Collector of Internal Revenue for the First District of California, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit, entered in the above cause on September 6, 1933, affirming the decision of the District Court for the Northern District of California.

OPINIONS BELOW

No written opinion was filed by the District Court. The opinion of the Circuit Court of Appeals (R. 54–60) is reported in 66 F. (2d) 895.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 6, 1933 (R. 60). A petition for rehearing was filed October 4, 1933, and was denied February 23, 1934 (R. 60–61). Subsequently a motion for leave to file a second petition for rehearing and for reconsideration was filed May 1, 1934 (R. 61–62). This motion was denied May 7, 1934 (R. 65–66). On May 15, 1934, Mr. Justice Sutherland entered an order granting an extension of time for filing a petition for a writ of certiorari for a period of thirty days from May 23, 1934 (R. 67). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the respondent was entitled to deduct losses and bad debts claimed to result upon the liquidation of its subsidiary where the respondent, through the medium of consolidated returns, had been enabled to deduct from its income losses of its subsidiary exceeding the amount of its investment in the subsidiary represented by the cost of its stock and advances.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 10–11.

STATEMENT

The respondent instituted this action in the District Court for the Northern District of California for the recovery of an alleged overpayment of income taxes for the calendar year 1923 in the amount of $143,122.23. The overpayment was alleged to result from the failure to allow as deductions for the taxable year a loss sustained upon the liquidation of A. F. Thane & Company and bad debts owing from the said company. The case was tried without a jury upon an agreed statement of facts which disclosed the following (R. 32–40):

Prior to 1920 the respondent, a Maine corporation, having its principal office in California, owned 540 of 600 shares outstanding of A. F. Thane & Company stock which it had acquired at a cost of $31,500 (R. 33). In 1920 the stock was increased to 5,000 shares and the respondent subscribed for 3,960 additional shares for which it paid $100 each. In 1921 the respondent purchased the remaining 500 shares for $52,125. The total sum paid for the 5,000 shares which it owned at the end of 1921 was $479,625 (R. 33–34). During the period between March 17, 1921, and the close of December, 1923, the respondent advanced cash to, paid accounts for, and assumed indebtedness of A. F. Thane & Company in the total amount of $1,234,157.09, for which it received partial repayment prior to the close of December, 1923, in the amount of $260,461.88 (R. 34). At the close of 1923 A. F. Thane & Company

was duly dissolved and was liquidated by transfer of all of its remaining assets to the respondent and by ceasing to do business. The assets thus transferred were carried on A. F. Thane & Company's books at a total value of $20,560.72 and were taken over by the respondent at this value (R. 34–35). The net amount due to the respondent as the result of all the above transactions was $953,134.49, which the respondent charged off its books as a debt ascertained to be worthless during the year 1923 (R. 35).

During the years 1920 to 1923, inclusive, the respondent was affiliated with A. F. Thane & Company and the Pacific Lumber Company, an Illinois corporation (R. 35–36). Separate tax returns were filed by each of these companies and also consolidated returns were filed showing the operations of the three companies. Taxes were paid upon the net income shown in the consolidated returns. The separate and consolidated returns showed the following net incomes and losses of the affiliated corporations (R. 36–37):

	1920	1921	1922	1923
Pacific Lumber Company of Maine, Respondent	$2,262,959.39	$379,624.88	$1,266,450.51	$1,379,494.78
A. F. Thane & Company	[1] 443,821.95	[1] 548,166.82	[1] 344,791.49	[1] 229,942.15
Pacific Lumber Company of Illinois	[1] 23,052.35	18,314.97	31,198.03	8,809.83
Consolidated	1,796,085.09	[1] 150,226.97	952,857.05	1,158,362.46

[1] Net loss.

The consolidated net loss of $150,226.97 for 1921 was allowed as a deduction from the consolidated net income for 1922, resulting in a consolidated net income for the latter year of $802,630.08, upon which the tax was paid.

Upon the consolidated income of $1,158,362.46 for the year 1923 the respondent paid to the petitioner the sum of $144,795.31 as the total income tax for that year. Thereafter upon examination and audit the respondent's corrected net income for the year 1923 was found to be $1,144,977.80 and the amount of $143,122.23 was found to be the total amount of income tax due. The respondent received a refund of $1,673.08, with interest, from the petitioner on account of the difference between the amount of tax shown on the return and the amount calculated upon the corrected net income. (R. 37–38.) On March 14, 1928, the respondent filed a claim for refund of the total amount of $143,122.23 together with interest thereon in the sum of $37,645.90. The claim was rejected by the Commissioner on June 14, 1928. (R. 38.)

The District Court entered judgment for the respondent in the principal amount of its claim together with interest to the date of judgment and with interest thereafter upon these amounts at 6 percent until paid (R. 29–31). The Circuit Court of Appeals affirmed the judgment of the District Court (R. 54–60).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the allowances claimed by the respondent as the result of the liquidation of A. F.

Thane & Company did not constitute a double deduction.

2. In holding that the petitioner had failed to establish any specific instance of a double deduction.

3. In failing and refusing to hold that the losses and bad debts claimed as deductions by the respondent for the year 1923 as a result of the liquidation of A. F. Thane & Company in the amounts of $479,625 and $953,134.49, respectively, must be offset by the losses sustained by A. F. Thane & Company during the years 1920 to 1923, inclusive, in the aggregate amount of $1,508,399.58 of which the respondent received the benefit as deductions in consolidated returns filed for such years.

4. In affirming the judgment of the District Court.

REASONS FOR GRANTING THE WRIT

The Collector urged before the Circuit Court of Appeals that the deduction claimed by the respondent was not allowable for two reasons: (1) Because the liquidation occurred during a consolidated return period and was consequently a nonrecognizable intercompany transaction, and (2) that the loss claimed on liquidation had theretofore been recovered by deduction of the subsidiary's losses on consolidated returns, in other words, that the allowance would give a double deduction. In failing to reverse the judgment of the District Court upon the basis of the Collector's second contention, we

submit that the Circuit Court of Appeals has reached a result directly contrary to the decision of this Court in *Charles Ilfeld Co.* v. *Hernandez,* No. 579, October Term, 1933, decided April 2, 1934.

In the *Ilfeld* case this Court held that no deduction could be allowed the taxpayer for losses sustained on the stock of and advances to its subsidiaries in the year in which the subsidiaries were liquidated. One of the reasons given for the disallowance was that since the taxpayer had been enabled, through the medium of consolidated returns in years prior to liquidation, to deduct operating losses of the subsidiaries aggregating more than the taxpayer's actual stock investment and advances, a further allowance on liquidation would be the practical equivalent of a double deduction, which could not be allowed in the absence of a statutory provision granting the right. The opinion of the Circuit Court of Appeals here, taken alone, does not disclose the inconsistency between the two cases, since the court stated that the Collector had failed to establish "any specific instance" of a double deduction. (R. 59.) But an examination of the stipulated facts in the instant case shows clearly their exact similarity to those in the *Ilfeld* case.

A footnote in this Court's opinion in the latter case shows that the taxpayer had deducted prior to 1929 operating losses of its subsidiaries in the aggregate amount of $190,431.66 and claimed an

investment loss in the subsidiaries for 1929, the year of liquidation, in the amount of $130,792.11, making a total of losses claimed of $321,223.77, while its actual investment (stock plus advances) amounted to but $168,812.49. The aggregate operating losses of the subsidiaries theretofore allowed ($190,431.66) exceeded the loss claimed on liquidation ($130,792.11) by $59,639.55. In the instant case the stipulation discloses (R. 36–37) that through the consolidated returns of the years 1920 to 1923, inclusive, the respondent deducted operating losses of A. F. Thane & Company, aggregating not less than $1,508,399.58. The investment loss claimed by the respondent for the year 1923 upon the stock and unrepaid advances amounted to $1,432,759.49, making a total of losses claimed of $2,941,159.07. The respondent's actual investment (stock plus advances) amounted to $1,713,782.09. The aggregate operating losses of the subsidiary theretofore allowed ($1,508,399.58) exceeded the loss claimed on liquidation ($1,432,759.49) by $75,640.09. These facts make it apparent that the allowance of any amount as a result of liquidation would be the practical equivalent of a double deduction.

The opinion and judgment of the Circuit Court of Appeals were filed before the decision of this Court was handed down in the *Ilfeld* case. But after that decision the Collector presented a motion for leave to file a petition for rehearing and

reconsideration (R. 61–62). The petition accompanying the motion demonstrated clearly the similarity between the situation here and that in the *Ilfeld* case and the fact that this Court's decision required a reversal of the District Court's judgment here (R. 62–65). The court below nevertheless denied the motion, leaving the Collector, as his only remedy, an application to this Court to correct the decision which, we submit, is manifestly erroneous.

Wherefore it is respectfully submitted that this petition should be granted and that the decision of the Circuit Court of Appeals should be reversed to accord with this Court's decision in the *Ilfeld* case.

J. CRAWFORD BIGGS,
Solicitor General.

JUNE 1934.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 254, 260:

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; unless, in order to clearly reflect the income, the loss should in the opinion of the Commissioner be accounted for as of a different period. * * *

(5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;

* * * * *

SEC. 240. (a) That corporations which are affiliated within the meaning of this section may, for any taxable year beginning on or after January 1, 1922, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

* * * * *

Treasury Regulations 62, promulgated under the Revenue Act of 1921:

> ART. 631. *Affiliated corporations.*—Consolidated returns are based upon the principle of levying the tax according to the true net income and invested capital of a single enterprise, even though the business is operated through more than one corporation. * * *
>
> ART. 636. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1934.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	5
Argument:	
I. Purpose of Consolidated Returns	6
II. Allowance of the loss would amount to double deduction	10
III. Double deduction should not be allowed	20
Conclusion	22
Appendix	24

CITATIONS

Cases:	
Atlantic City Co. v. *Commissioner*, 288 U. S. 152	8
Bank of Commerce v. *Tennessee*, 161 U. S. 134	20
Burnet v. *Aluminum Goods Co.*, 287 U. S. 544	6, 10, 20
Burnet v. *Riggs Nat. Bank*, 57 F. (2d) 980	19
Eisner v. *Macomber*, 252 U. S. 189	9
Golden Cycle Corp. v. *Commissioner*, 51 F. (2d) 927	9
Handy & Harman v. *Burnet*, 284 U. S. 136	6
Ilfeld Co. v. *Hernandez*, 292 U. S. 62	10, 11, 12, 13, 17, 22
Reinecke v. *Smith*, 289 U. S. 172	9
Swift & Co. v. *United States*, 38 F. (2d) 365, ~~affirmed 282 U. S. 468~~	8
Tyler v. *United States*, 281 U. S. 497	9
United States v. *Dickson*, 15 Pet. 141	21
United States v. *Lakewood Engineering Co.*, 70 F. (2d) 887	13, 14
Woolford Realty Co. v. *Rose*, 286 U. S. 319	18
Statute:	
Revenue Act of 1921, c. 136, 42 Stat. 227, 254, 260:	
Sec. 234	24
Sec. 240	24
Miscellaneous:	
Treasury Regulations 62:	
Art. 631	25
Art. 636	25

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 125

JOHN P. MCLAUGHLIN, COLLECTOR OF INTERNAL REVENUE for the First District of California, petitioner

v.

PACIFIC LUMBER COMPANY, A CORPORATION

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

No written opinion was filed by the District Court. The opinion of the Circuit Court of Appeals (R. 54–60) is reported in 66 F. (2d) 895.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 6, 1933 (R. 60). A petition for rehearing was filed October 4, 1933, and was denied February 23, 1934 (R. 60–61). Subse-

quently a motion for leave to file a second petition for rehearing and for reconsideration was filed May 1, 1934 (R. 61–62). This motion was denied May 7, 1934 (R. 65–66). On May 15, 1934, Mr. Justice Sutherland entered an order granting an extension of time for filing a petition for a writ of certiorari for a period of thirty days from May 23, 1934 (R. 67). The petition for a writ of certiorari was filed June 22, 1934, and granted October 8, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the respondent was entitled to deduct stock losses and bad debts claimed to result upon the liquidation of its subsidiary where the respondent, through the medium of consolidated returns, had been allowed to deduct from its income losses of its subsidiary exceeding the amount of its investment in the subsidiary represented by the cost of its stock of the subsidiary and advances to it.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 24–25.

STATEMENT

The respondent instituted this action in the District Court for the Northern District of California for the recovery of an alleged overpayment of income taxes for the calendar year 1923 in the amount of $143,122.23. The overpayment was alleged to

result from the failure to allow as deductions for the taxable year a loss sustained upon the liquidation of A. F. Thane & Company and bad debts owing from the said company. The case was tried without a jury upon an agreed statement of facts which disclosed the following (R. 32–40):

Prior to 1920 the respondent, a Maine corporation, having its principal office in California, owned 540 of 600 shares outstanding of A. F. Thane & Company stock which it had acquired at a cost of $31,500 (R. 33). In 1920 the stock was increased to 5,000 shares and the respondent subscribed for 3,960 additional shares, for which it paid $100 each. In 1921 the respondent purchased the remaining 500 shares for $52,125. The total sum paid for the 5,000 shares which it owned at the end of 1921 was $479,625 (R. 33–34). During the period between March 17, 1921, and the close of December 1923 the respondent advanced cash to, paid accounts for, and assumed indebtedness of A. F. Thane & Company in the total amount of $1,234,157.09, for which it received partial repayment prior to the close of December 1923 in the amount of $260,461.88 (R. 34). At the close of 1923 A. F. Thane & Company was duly dissolved and was liquidated by transfer of all of its remaining assets to the respondent and by ceasing to do business. The assets thus transferred were carried on A. F. Thane & Company's books at a total value of $20,560.72 and were taken over by the respondent at this value (R. 34–35). The net amount due to the respondent

as the result of all the debt transactions was $953,134.49, which the respondent charged off its books as a debt ascertained to be worthless during the year 1923 (R. 35).

During the years 1920 to 1923, inclusive, the respondent was affiliated with A. F. Thane & Company and the Pacific Lumber Company, an Illinois corporation (R. 35–36). Separate tax returns were filed by each of these companies and also consolidated returns were filed showing the operations of the three companies. Taxes were paid upon the net income shown in the consolidated returns. The separate and consolidated returns showed the following net incomes and losses of the affiliated corporations (R. 36–37):

	1920	1921	1922	1923
Pacific Lumber Company of Maine, Respondent	$2,262,959.39	$379,624.88	$1,266,450.51	$1,379,494.78
A. F. Thane & Company	[1] 443,821.95	[1] 548,166.82	[1] 344,791.49	[1] 229,942.15
Pacific Lumber Company of Illinois	[1] 23,052.35	18,314.97	31,198.03	8,809.83
Consolidated	1,796,085.09	[1] 150,226.97	952,857.05	1,158,362.46

[1] Net loss.

The consolidated net loss of $150,226.97 for 1921 was allowed as a deduction from the consolidated net income for 1922, resulting in a consolidated net income for the latter year of $802,630.08, upon which the tax was paid.

Upon the consolidated income of $1,158,362.46 for the year 1923 the respondent paid to the petitioner the sum of $144,795.31 as the total income tax for that year. Thereafter upon examination and audit the respondent's corrected net income for the year 1923 was found to be $1,144,977.80 and the

amount of $143,122.23 was found to be the total amount of income tax due. The respondent received a refund of $1,673.08, with interest, from the petitioner on account of the difference between the amount of tax shown on the return and the amount calculated upon the corrected net income (R. 37–38). On March 14, 1928, the respondent filed a claim for refund of the total amount of $143,122.23, together with interest thereon. The claim was rejected by the Commissioner on June 14, 1928 (R. 38).

The District Court entered judgment for the respondent in the principal amount of $143,122.23 with interest thereon to January 13, 1932, in the sum of $64,977.53 and interest on these amounts from January 13, 1932, until paid (R. 29–31). The Circuit Court of Appeals affirmed the judgment of the District Court (R. 54–60).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the allowances claimed by the respondent as the result of the liquidation of A. F. Thane & Company did not constitute a double deduction.

2. In holding that the petitioner had failed to establish any specific instance of a double deduction.

3. In failing and refusing to hold that the stock losses and bad debts claimed as deductions by the

respondent for the year 1923 as a result of the liquidation of A. F. Thane & Company in the amounts of $479,625 and $953,134.49, respectively, totalling $1,432,759.49, must be offset by the losses sustained by A. F. Thane & Company during the years 1920 to 1923, inclusive, in the aggregate amount of $1,508,399.58, of which the respondent received the benefit as deductions in consolidated returns filed for such years.

4. In affirming the judgment of the District Court.

ARGUMENT

I

PURPOSE OF CONSOLIDATED RETURNS

The purpose of requiring a consolidated return by affiliated corporations was to provide for the levying of the tax on the true net income of a single business enterprise, even though the business was operated through more than one corporation. The above principle was laid down in Treasury Regulations 62, Article 631, and was approved by this Court in *Handy & Harman* v. *Burnet,* 284 U. S. 136. In *Burnet* v. *Aluminum Goods Co.,* 287 U. S. 544, this Court said (p. 547):

> Primarily, the consolidated return was to preclude reduction of the total tax payable by the business, viewed as a unit, by redistribution of income or capital among the component corporations by means of intercompany transactions.

The Court pointed out that the underlying purpose of the statute and regulations governing the consolidated returns was (p. 550)—

> to prevent, through the exercise of a common power of control, any intercompany manipulation which would distort invested capital or the true income of the unitary business carried on by the affiliated corporations. * * *

The Court laid down the groundwork for its decision in the *Ilfeld* case in ruling that equitable principles of accounting should be applied in calculating the true income of the business unit, thereby precluding (p. 550)—

> any intercompany manipulation which would distort invested capital or the true income of the unitary business carried on by the affiliated corporations.

In concluding its opinion, the Court laid down the general rule that the pertinent regulations required (p. 551)—

> the elimination of any losses resulting from intercompany transactions the inclusion of which would defeat the purpose of consolidated returns to tax the true income of the single business of affiliated corporations, calculated by correct accounting methods. * * *

The consolidated group, as such, is not a taxpayer but a tax-computing unit, and the corporations which are members of the affiliated group lose their

separate identity while so affiliated only for the purpose of computation of the tax upon one income, which is the true net income of such combined corporations. (*Swift & Co.* v. *United States*, 38 F. (2d) 365 (C. Cls.), ~~affirmed, 282 U. S. 468~~. The consolidated return provisions view the business as a unit, in practical effect a single enterprise conducting the business through several different branches. "The purpose of the Congress was to secure substantial equality among stockholders who ultimately bear the burden of taxation and to prevent evasion through the manipulation of intercompany transactions." *Atlantic City Co.* v. *Commissioner*, 288 U. S. 152, 154. If the respondent had in fact conducted its business through unincorporated branches, the double deduction here claimed would be impossible.

The fact that the purchase of the stock by the parent represented a capital investment, while the losses of the subsidiary in years prior to liquidation were operating losses, can not serve to permit the parent to recover more than its actual investment. The operating losses of prior years were not the respondent's but were those of the subsidiary. As they occurred they served to impair the capital value of the subsidiary equally with the amount of the advances made by the respondent for use in the subsidiary's operations. These losses were reflected in the diminishing value of the parent's stock investment in the subsidiary and the obligations represented by the advances. Mere

nomenclature can not suffice to give a double allowance.

The construction of tax statutes and the application of those statutes to individual cases is a problem for practical minds wherein technical refinements should be disregarded. One must have regard "to the very truth of the matter, to substance and not to form". *Eisner* v. *Macomber,* 252 U. S. 189, 211.

In the case of *Tyler* v. *United States,* 281 U. S. 497, Mr. Justice Sutherland said (p. 503):

> The power of taxation is a fundamental and imperious necessity of all government, not to be restricted by mere legal fictions. * * * Taxation, as it many times has been said, is eminently practical, * * *

See also *Reinecke* v. *Smith,* 289 U. S. 172, at p. 177.

Other cases referring to the purpose of consolidated returns are collected in the opinion of the Circuit Court of Appeals for the Tenth Circuit in the case of *Golden Cycle Corp.* v. *Commissioner,* 51 F. (2d) 927, and discussed at pages 931–932:

> There is no obscurity as to the purpose of these statutes and regulations. Their purpose was to prevent corporations from avoiding the payment of their share of the war taxes by the device of affiliation. When the 1918 act was before Congress, the chairman of the Finance Committee recommended its passage "because the principle of taxing as a business unit what in reality is a business unit is sound and equitable."

The ranking minority member of the Committee joined in the recommendation, saying, "It is impossible to determine the true profits of such a combined enterprise except by treating the enterprise as a unit and disregarding the incidental placing of different branches in legally separate corporations." The statutes and the regulations have been many times construed.

II

ALLOWANCE OF THE LOSS WOULD AMOUNT TO DOUBLE DEDUCTION

Where, through the medium of consolidated returns for prior years, the parent corporation has been enabled to deduct operating losses of the subsidiary aggregating more than the parent's actual stock investment and advances, a further allowance on liquidation of the subsidiary would be the practical equivalent of a double deduction, which should not be allowed. In support of the above argument counsel for the petitioner rely chiefly upon the principles enunciated by this Court in *Burnet* v. *Aluminum Goods Co., supra,* and applied in the case of *Ilfeld Co.* v. *Hernandez,* 292 U. S. 62, the facts of the *Ilfeld* case being identical with those of the case at bar.

In the decision in the *Ilfeld* case, *supra,* this Court concluded that the principle, laid down in the *Aluminum Goods Co.* case, should be applied for the reason that the deductions claimed would have the effect of defeating the purpose of consolidated

returns to tax the true income of the single business of affiliated corporations. One of the reasons given for the disallowance was that since the taxpayer had been enabled, through the medium of consolidated returns in the years prior to liquidation, to deduct operating losses of the subsidiary aggregating more than the parent's actual stock investment and advances, a further allowance on liquidation of the subsidiary would be the practical equivalent of a double deduction, which could not be allowed in the absence of a statutory provision granting the right. Since the decision of this Court in the *Ilfeld* case is deemed controlling in the present case, the factual similarity of the two cases will be pointed out.

A footnote in this Court's opinion in the *Ilfeld* case shows that the taxpayer had deducted prior to 1929 operating losses of its subsidiaries in the aggregate amount of $190,431.66 and claimed an investment loss in the subsidiaries for 1929, the year of liquidation, in the amount of $130,792.11, making a total of losses claimed of $321,223.77, while its actual investment (stock plus advances) amounted to but $168,812.49. The aggregate operating losses of the subsidiaries theretofore allowed ($190,431.66) exceeded the loss claimed on liquidation ($130,792.11) by $59,639.55. In the instant case the agreed statement of facts discloses (R. 36–37) that through the consolidated returns of the years 1920 to 1923, inclusive, the respondent deducted operating losses of A. F. Thane & Company,

aggregating not less than $1,508,399.58. The investment loss claimed by the respondent for the year 1923 upon the stock and unrepaid advances amounted to $1,432,759.49, making a total of losses claimed of $2,941,159.07, while the respondent's actual investment (stock plus advances) amounted to $1,713,782.09, subject to credits of $281,022.60; leaving $1,432,759.49. The aggregate operating losses of the subsidiary theretofore allowed ($1,508,399.58) exceeded the loss claimed on liquidation ($1,432,759.49) by $75,640.09. These facts make it clear that the allowance of any amount as a result of liquidation to the respondent would be the practical equivalent of a double deduction, as was held in the *Ilfeld* case.

The liquidating loss of $130,792.11, claimed by the parent in the *Ilfeld* case for the year 1929, was disallowed. This Court disallowed the loss on two grounds: (1) Because it was not permissible under Regulations 75, applicable to 1929 and subsequent years, and (2) because in practical effect it would constitute a second deduction for losses theretofore allowed the parent by the deduction of its subsidiaries' operating losses. With respect to the second ground, the Court said in part (p. 68):

> The allowance claimed would permit petitioner twice to use the subsidiaries' losses for the reduction of its taxable income. By means of the consolidated returns in earlier years it was enabled to deduct them. And now it claims for 1929 deductions for dimi-

> nution of assets resulting from the same losses. If allowed, this would be the practical equivalent of double deduction. In the absence of a provision of the Act definitely requiring it, a purpose so opposed to precedent and equality of treatment of taxpayers will not be attributed to lawmakers. Cf. *Burnet* v. *Aluminum Goods Co.*, 287 U. S. 544, 551. *United States* v. *Ludey*, 274 U. S. 295, 301. * * *

The decision in the *Ilfeld* case, therefore, directly governs this case and shows that the deduction claimed by the taxpayer and allowed by the Circuit Court of Appeals must be denied.

In the very recent case of *United States* v. *Lakewood Engineering Co.*, 70 F. (2d) 887 (C. C. A. 6th), the court not only followed the *Ilfeld* case but extended its principles so as to preclude double deduction of losses even where the stock of the subsidiary was sold at a loss to an outsider. There the taxpayer argued that the cases involving a loss sustained by the parent corporation upon the *liquidation* of a subsidiary, where the operating losses of the subsidiary had been used as deductions in consolidated returns, were not controlling in that here there was a *sale* of the stock of the subsidiary to an *outsider* and that such sale could not be considered an *intercompany* transaction. In answer to this argument the Court pointed out that no such distinction was recognized as important in the *Ilfeld* case. The Court then proceeded to dis-

pose of the case on the broad principles of equitable accounting in the following manner (p. 888):

> Notwithstanding the argument that each of the affiliated corporations is entitled to make the same deduction from net income under the law as it would if it had filed an independent return, and that the subsidiary having suffered an operating loss, and the parent corporation a loss in its investment in the stock of the subsidiary, each is entitled to deduct the full amount of such loss, and that the losses are in no way related, it is difficult to escape the conclusion that the deductions are duplicated. It is true that, if one company standing alone loses upon its investment, it is entitled to deduct its loss. It is equally true that, if the other, standing alone, has an operating loss, it returns no income, but its net loss is of no benefit to anyone as a deduction for the taxable year. The consolidation of returns, however, permits the employment of the subsidiary's loss as a deduction from the net income of the group for the taxable year in which the loss is sustained (*Woolford Realty Co.* v. *Rose, Commissioner,* 286 U. S. 319), and so accrues to the benefit of the parent company in its computation of tax liability. The taxpayer here, however, computes its cost of the stock in the subsidiary by adding to the original purchase price the advances made to its affiliate without making any adjustment for the loss already deducted from income due to operations of its subsidiary, of which it has

already had the benefit, and of which in the absence of affiliation it could not have availed itself.

Let us consider the practical question of whether there is in substance a double deduction here under principles of equitable accounting.

Prior to dissolution the Thane Company sold substantially all its operating assets; these sales were reported in the consolidated return and were included properly in its computation of consolidated net income. The losses sustained thereby were deducted in such consolidated return. The mere act of winding up the subsidiary and dissolving it with the transfer of remaining assets certainly did not give rise to a deductible loss from the viewpoint of the consolidation; that loss had already been suffered over a period of years and was already reflected in the consolidated returns. There was no act or occurrence which was not entirely within the control and power of the parent company; no outside group was affected; it was the mere dissolving of the form of an intercompany relation, which act of itself brought nothing into the affiliated group and saw nothing go out of the group.

Advances made by a parent corporation to its subsidiaries are in their very nature intercompany transactions representing the lending of money by one branch of the business to another for operating purposes. In such case the loss of the group as a

whole has not occurred when the obligation to repay the amount became worthless but at some prior time when the money borrowed was lost in operations. Such a loss has already been reflected by way of deduction either against the income of a successful member of the group or against that of the borrower by carrying it forward under the authority of the net loss provisions of the statutes. To allow the loss on liquidation would clearly result in a duplication of deductions.

An example will show the extent to which such an allowance might possibly be taken. Corporations A, B, and C are affiliated. In 1920 A lends $4,000 to B and B lends the same $4,000 to C to cover a current operating loss. The affiliated group takes a deduction for C's operating loss in 1920. In 1921 C becomes insolvent and B charges off the debt as worthless. In 1922 B becomes insolvent and A gets a deduction for a bad debt. Under such circumstances A, having income in excess of its subsidiaries' losses for each of the years, would have benefited three times on account of the one ultimate loss.

Similarly, the investment in the subsidiary by the purchase of its stock would be the subject of duplicate deductions if the deduction were allowed when the subsidary is liquidated. As a result of purchasing the stock the parent acquires the subsidiary and its assets and operates it as a branch. The cost of these assets, gradually dissipated through operations, will have been represented by deductions taken by the affiliated group

in prior years. To allow their deduction again as capital losses or worthless debts would be to distort the income and to permit, rather than to prevent, the avoidance of tax liability.

The rule of law to be applied to such a set of facts, as found in the case at bar, is clearly provided by this Court in the *Ilfeld* case, to the effect that where, through the medium of consolidated returns during prior years, the taxpayer has been enabled to deduct from its income operating losses of a subsidiary, such losses must be offset against the alleged losses resulting from the subsequent liquidation of the subsidiary. The rule is general and deals with totals rather than detailed items. There is no question of fact involved in the instant case. All essential facts are embodied in the agreed statement of facts, which is a part of the record before this Court. It was beside the point for the lower court to say that the Collector of Internal Revenue should establish specific instances of double deductions, and that a mere similarity of totals as between different years does not justify the inference that the deduction is a double one. The lower court's reasons for refusing to follow the principles laid down by this Court are not clearly stated. The conclusion that the Collector failed to establish any specific instance of a double deduction indicates that the lower court misinterpreted the facts of record, while the statement concerning mere similarity of totals indicates that it

has misconstrued the meaning of a double deduction in cases of affiliated corporations.

The allowance of such deduction would open the door to a method whereby an affiliated group, consisting of parent and subsidiaries, can avoid taxes entirely by saddling upon one of the subsidiaries the unprofitable parts of the enterprise, having that subsidiary borrow from the parent company in order to pay its current obligations, the annual deficit being written off as an operating loss and deducted in the consolidated return, and then, after a number of years dissolving the "unprofitable" subsidiary and absorbing its assets and business, thus taking the loss a second time. The following statement from the opinion of Mr. Justice Cardozo in *Woolford Realty Co.* v. *Rose,* 286 U. S. 319, 329–330, may well be applied to the issue in this case:

> Doubt, if there can be any, is not likely to survive a consideration of the mischiefs certain to be engendered by any other ruling. A different ruling would mean that a prosperous corporation could buy the shares of one that had suffered heavy losses and wipe out thereby its own liability for taxes. The mind rebels against the notion that Congress in permitting a consolidated return was willing to foster an opportunity for juggling so facile and so obvious. Submission to such mischiefs would be necessary if the statute were so plain in permitting the deduction as to leave no room for choice between that construction and another. Expediency may

> tip the scales when arguments are nicely balanced. True, of course, it is that in a system of taxation so intricate and vast as ours there are many other loopholes unsuspected by the framers of the statute, many other devices whereby burdens can be lowered. This is no reason, however, for augmenting them needlessly by the addition of another. * * *

The case of *Burnet* v. *Riggs Nat. Bank,* 57 F. (2d) 980 (C. C. A. 4th), clearly supports the petitioner in the instant case. There the court allowed the parent corporation to deduct such portion of the loss sustained on the liquidation of the subsidiary as was not included in the prior consolidated return, but then went on to say (pp. 983–984):

> On the other hand, we are convinced that the Board of Tax Appeals was right in refusing to allow the claim of the Riggs Bank for the entire loss as at the time of the liquidation, because of the fact that a part of this loss had been deducted by the bank in its return for the first part of the year 1922. To allow the entire loss as of June 10, 1922, would have resulted in respondent receiving credit twice for a part of the loss. *David M. Goodrich* v. *Williams H. Edwards,* 255 U. S. 527, 41 S. Ct. 390, 65 L. Ed. 758; *United States* v. *Ludey,* 274 U. S. 295, 47 S. Ct. 608, 71 L. Ed. 1054.
>
> Double credits equally with double taxation are to be avoided where possible in construing laws passed by Congress.

III

DOUBLE DEDUCTION SHOULD NOT BE ALLOWED

The statute never contemplated that losses should be deducted twice, and unless a double deduction is plainly required it should not be allowed. This Court recently stated the above principle in the *Aluminum Goods Co.* case, supra, where it said (p. 551) that—

> equitable principles of accounting applied to the calculation of the net income of the business unit do not permit deduction of the loss twice, * * *.

Being a grant of special privilege, a claimed deduction must come squarely within the statute. Double deductions like double taxation should never be presumed, and should always be avoided unless clearly provided for by the statute. The statute allows the deduction of losses sustained during the taxable year and not compensated for by insurance or *otherwise*. See Section 234, Revenue Act of 1921. In the instant case, the Government contends that the claimed deduction has already been compensated for by the losses returned by the consolidated group. It has been repeatedly held that the taxpayer, in claiming a beneficial exception, must show a clear right. In the case of *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, this Court said (p. 146):

> Taxes being the sole means by which sovereignties can maintain their existence, any claim on the part of any one to be exempt from the full payment of his share of taxes on any portion of his property must on that account be clearly defined and founded upon plain language. There must be no doubt or ambiguity in the language used upon which the claim to the exemption is founded. It has been said that a well-founded doubt is fatal to the claim; no implication will be indulged in for the purpose of construing the language used as giving the claim for exemption, where such claim is not founded upon the plain and clearly expressed intention of the taxing power.

The general rule was laid down in the case of *United States* v. *Dickson,* 15 Pet. 141, where Mr. Justice Story used this language (p. 165):

> we are led to the general rule of law, which has always prevailed, and become consecrated almost as a maxim in the interpretation of statutes, that where the enacting clause is general in its language and objects, and a proviso is afterwards introduced, that proviso is construed strictly, and takes no case out of the enacting clause which does not fall fairly within its terms. In short, a proviso carves special exceptions only out of the enacting clause; and those who set up any such exception, must establish it as being within the words as well as within the reasons thereof.

And finally, in the *Ilfeld Co.* case, *supra,* which we contend is controlling, this Court said that a deduction is not allowable unless a provision in the Act or regulations may fairly be read to authorize it, and concluded that the deduction if allowed (p. 68)—

> would be the practical equivalent of double deduction. In the absence of a provision of the Act definitely requiring it, a purpose so opposed to precedent and equality of treatment of taxpayers will not be attributed to lawmakers. * * *

To allow the deduction claimed in the instant case would not only distort the underlying purpose of the provisions allowing consolidated returns but would also violate the cardinal rule of construction referred to in the preceding paragraph. In viewing the facts of the case at bar, one cannot fail to conclude that there is the practical equivalent of double deduction.

CONCLUSION

The parent corporation, through the medium of consolidated returns for prior years, has received the benefit of deductions from its income on account of losses of the subsidiary exceeding in amount the losses now claimed. The allowance of the deduction now claimed would amount to a double deduction.

We respectfully submit that the decision of the court below is erroneous and should be reversed.

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FRANK J. WIDEMAN,
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SEWALL KEY,
JOSEPH M. JONES,
Special Assistants to the Attorney General.

OCTOBER 1934.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 254, 260:

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; unless, in order to clearly reflect the income, the loss should in the opinion of the Commissioner be accounted for as of a different period. * * *

(5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;

* * * * *

SEC. 240. (a) That corporations which are affiliated within the meaning of this section may, for any taxable year beginning on or after January 1, 1922, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such

bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

* * * * *

Treasury Regulations 62:

ART. 631. *Affiliated corporations.*—Consolidated returns are based upon the principle of levying the tax according to the true net income and invested capital of a single enterprise, even though the business is operated through more than one corporation. * * *

ART. 636. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. * * *

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1934

No. 125

JOHN P. McLAUGHLIN, Collector of Internal Revenue for the First District of California,

Petitioner,

vs.

PACIFIC LUMBER COMPANY (a corporation),

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

F. D. MADISON,
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Table of Contents

		Page
I.	Statement of facts	1
II.	Argument	2
	A. The petition for certiorari merely asks this court to reverse the finding of the court below	2
	B. The facts were correctly found by the Circuit Court of Appeals	6
	C. None of the specifications of error is tenable	8
	D. The Circuit Court of Appeals did not err in denying petitioner's motions	9
III.	Summary	10

Table of Authorities Cited

	Pages
Apartment Corporation v. Helvering, No. 690, October Term 1933.	
Memorandum for Respondent, p. 2	4
Bronson v. Schulten, 104 U. S. 410, 415	10
Brooks v. Railroad Company, 102 U. S. 107	10
Burnet v. Aluminum Goods Company, 287 U. S. 544	3, 8, 9
Charles Ilfeld Company v. Hernandez, No. 579, October Term 1933, decided April 2, 1934	2, 3, 4, 5, 6, 8, 9
Brief for Respondent in Opposition, p. 10	4
Brief for Respondent, pp. 26-27	4
Ex parte National Park Bank, 256 U. S. 131	10
Luckenbach v. McCahan Sugar Co., 248 U. S. 139, 145	5
Schell v. Dodge, 107 U. S. 629	10
Sibbald v. United States, 12 Pet. 488, 492	10
Southern Power Co. v. Pub. Serv. Co., 263 U. S. 508, 509	5
Texas & N. O. R. Co. v. Ry. Clerks, 281 U. S. 548, 558	5
United Publishers' Corporation v. Anderson, 42 F. (2d) 781	4
American Bar Association Journal, Vol. XX, p. 341	5

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BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

I. STATEMENT OF FACTS.

Respondent acquired the entire capital stock of A. F. Thane & Company. To this subsidiary respondent advanced money. The subsidiary suffered current losses which were reflected on consolidated returns. In 1923 the subsidiary was dissolved. The proceeds

in liquidation were insufficient to repay the respondent either the amount advanced to the subsidiary or the amount paid by respondent for the subsidiary's stock. These losses were also deducted for 1923. So far we are in entire accord with petitioner's statement.[1]

But there is no evidence of double deduction, no specific instance of such deduction.[2]

The district court found for respondent.[3]

The Circuit Court of Appeals affirmed,[4] making the specific finding italicized above. On petition for rehearing[5] and on a motion for leave to file a second petition for rehearing,[6] the Circuit Court of Appeals refused to depart from this finding.

II. ARGUMENT.

A. THE PETITION FOR CERTIORARI MERELY ASKS THIS COURT TO REVERSE THE FINDING OF THE COURT BELOW.

No question of law is presented by the petitioner. The principles of law adopted by the Circuit Court of Appeals are the same as those laid down in the only decision cited by petitioner.[7] That case, it is true, was decided by this court after the decision of the Circuit Court of Appeals in this case. Nevertheless, so far as the points here discussed are concerned, each of them is based upon and follows implicitly an

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1. Petition, pp. 3-5.
2. See the finding of the Circuit Court of Appeals (R. 59).
3. R. 29-31.
4. R. 54-60.
5. R. 60-61.
6. R. 66.
7. *Charles Ilfeld Co. v. Hernandez*, No. 579, October Term, 1933, decided April 2, 1934 (Petition, pp. 7-9).

earlier decision of this court.[8] The Circuit Court of Appeals applied to this case the explicit statement of this court in its earlier decision that equitable principles do not permit the deduction of the same loss twice.[9] That is the only principle of law involved. Whether the loss, the deduction of which is sought, is the same or a different loss must always be a question of fact. Recognizing and applying to the facts disclosed by the record in this case the principle of law laid down by this court in the *Aluminum* case and confirmed in the *Ilfeld* case, the Circuit Court of Appeals determined the issue of fact against petitioner. This issue of fact, which the two courts below have determined against petitioner and which the Circuit Court of Appeals has twice refused to reexamine, is the issue which petitioner now asks this court to review.

The Solicitor General has already made it clear to this court that such is the nature of the question involved in the case at bar. In the petition for certiorari in the *Ilfeld* case, the taxpayer there had urged that the decision of the Circuit Court of Appeals for the Tenth Circuit in favor of the Government was in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in our favor in this case. Combating the assertion that such conflict existed, the Solicitor General said that in our case,

> "The court did not specifically hold that prior years' losses taken as deductions by the parent should not be offset against a loss on liquidation

8. *Burnet v. Aluminum Goods Company*, 287 U. S. 544 (R. 56-59).
9. R. 58.

> *but stated that the Collector had failed to establish any specific instance of double deduction.*"[10]

The distinction so stated by the Solicitor General between the case at bar and the *Ilfeld* case was adopted by this court in the *Ilfeld* decision. In the final paragraph of that decision this court said that the weight of authority was against the taxpayer's contention, that no decision other than that of the district court in *United Publishers' Corporation v. Anderson,*[11] gave any support to the taxpayer's claim and directed the comparison of that case with the decision of the Circuit Court of Appeals in this case. With the case at bar definitely in mind, then, this court said that only the *United Publishers'* decision supported the claim of the Ilfeld Company. The matter could not have been put more explicitly if this court had said directly that this case was not the *Ilfeld* case.

The petition here can not avoid recognizing this fact. Petitioner says:

> "The opinion of the Circuit Court of Appeals here, taken alone, does not disclose the inconsistency between the two cases, since the court stated that the Collector had failed to establish 'any specific instance' of a double deduction."[12]

Petitioner, therefore, invites this court to "*an examination of the stipulated facts in the instant case*",

10. No. 579 (October Term, 1933), Brief for Respondent in Opposition, p. 10. The statement is repeated in the same case in the Brief for the Respondent, pp. 26-27, and in No. 690 (October Term, 1933), *Apartment Corporation v. Helvering*, Memorandum for Respondent, p. 2.
11. 42 F. (2d) 781.
12. Petition, p. 7.

saying that such an examination would show "their exact similarity to those in the *Ilfeld* case."[13] Petitioner is simply asking this court to scrutinize the records in this case and the *Ilfeld* case, to compare figures and make computations and from them to determine whether the Circuit Court of Appeals in this case was correct in its finding that there was no double deduction, and in its comment that: "similarity of totals as between different years does not justify the inference that the deduction is a double one" (R. 59). Even after this court has issued certiorari, it will not reexamine issues of fact in the decision of which two lower courts have concurred;[14] much less will it issue certiorari for the sole purpose of making such a reexamination.[15] Certiorari will not be granted where, as here, the question turns upon the facts of the particular case, where there is no controversy whatever with respect to legal principles, where there is no real conflict with decisions of this court.

> "That review, we must emphasize, is in the interest of the law, not in the interest of particular parties. It is not the importance of the parties or the amount involved that is controlling, but the need of securing harmony of decision and the appropriate settlement of questions of general importance so that the system of federal justice may be appropriately administered."[16]

To summarize, the different results reached by the Circuit Court of Appeals for the Ninth Circuit in this

13. Petition, p. 7.
14. *Luckenbach v. McCahan Sugar Co.*, 248 U. S. 139, 145; *Texas & N. O. R. Co. v. Ry. Clerks*, 281 U. S. 548, 558.
15. *Southern Power Co. v. Pub. Serv. Co.*, 263 U. S. 508, 509.
16. *American Bar Association Journal*, Vol. XX, p. 341.

case and by this court and the Circuit Court of Appeals for the Tenth Circuit in the *Ilfeld* case, are due entirely to a difference in the facts in the two cases, as found by the lower courts. In the *Ilfeld* case and in another case in this court, the Solicitor General pointed this out explicitly. This court accepted the distinction pointed out by the Solicitor General and decided the *Ilfeld* and the other case in favor of the Government. The Solicitor General now reverses his position and asks this court to take jurisdiction of this case because, as he says, the Circuit Court of Appeals in this case "has reached a result directly contrary to the decision of this court"[17] in the *Ilfeld* case.

B. THE FACTS WERE CORRECTLY FOUND BY THE CIRCUIT COURT OF APPEALS.

Petitioner's theory regarding the facts is clearly that having shown the losses of the subsidiary taken as deductions on the consolidated returns in excess of the parent's loss in liquidation of the subsidiary, "These facts make it apparent that the allowance of any amount as a result of liquidation would be the practical equivalent of a double deduction."[18] This is clearly a *non sequitur.*

Undoubtedly, there are some losses or expenses of a subsidiary which would reduce the parent's tax on consolidated returns and which also would be reflected in investment losses of the parent on dissolution of

17. Petition, p. 7.
18. Petition, p. 8.

the subsidiary or sale of its stock. There are other transactions, however, which might show up as such losses on the part of the subsidiary deductible on the consolidated returns but which would not be reflected in an investment loss of the parent, and there are matters which would be reflected as such investment losses which could in no way have been taken as current deductions on the consolidated returns. Examples of the latter might be the circumstance established by the record here that the parent purchased the stock of the subsidiary for more than its book value on the subsidiary's books, or other circumstances, such as losses of the subsidiary incurred abroad and other expenses of the subsidiary which are not deductible under the income tax laws. Examples of the former might be such transactions of the subsidiary as resulted in items deductible on income tax returns but not involving actual loss or else balanced in turn by income of the subsidiary, e. g., Liberty Bond interest, dividends from domestic corporations, or excluded foreign income which would not appear on the income tax returns because not taxable as income. The business of the subsidiary in this case was complicated, extensive and carried on both in the United States and foreign countries. The record does not disclose the details and it would not be proper for us to go into them. It must be clear, however, that the mere showing that during affiliation losses of the subsidiary have appeared on the consolidated returns aggregating an amount in excess of

the investment loss of the parent on dissolution, does not show the existence of any duplication or double deduction.

C. NONE OF THE SPECIFICATIONS OF ERROR IS TENABLE.

These considerations are given point by an examination of the four specifications of error urged by petitioner.[19] The first specification is:

> "In holding that the allowances claimed by the respondent as the result of the liquidation of A. F. Thane & Company did not constitute a double deduction."[20]

This "holding" is a mere determination of a matter of fact. It cannot be directly contrary to the decision of this court in the *Ilfeld* case,[21] because in the *Ilfeld* case this court was not considering the facts in the case at bar and made no determination of fact in the *Ilfeld* case, simply accepting the record as it came from the court below. It is interesting also that the issue of "double deduction" was at no time raised by the answer in the case at bar[22] or even by the assignments of error in the Circuit Court of Appeals.[23] At that time, indeed, and up to the time of the decision of this court in the *Aluminum* case, petitioner was contending, not that a double deduction existed

19. Petition, pp. 5-6.
20. Petition, pp. 5-6.
21. Petition, p. 7.
22. R. 16-21.
23. R. 44-46.

as a matter of fact, but that as a matter of law liquidation losses of this kind could never be deducted.

The second specification attacks the "holding that the petitioner had failed to establish any specific instance of a double deduction."[24] This is quite similar to the first.

The third specification attacks the failure to hold that the losses of the parent on liquidation should have been offset by the current losses of the subsidiary shown on the consolidated returns.[25] Since the court had found as a fact that no double deduction existed, it could not have been error for it to fail to hold in accordance with petitioner's contention. Granted the fact that no double deduction existed, to hold in favor of petitioner would have violated the rule laid down by this court in the *Aluminum* case and impliedly affirmed by it in the *Ilfeld* case.

The fourth specification of error[26] is general and of no effect.

D. THE CIRCUIT COURT OF APPEALS DID NOT ERR IN DENYING PETITIONER'S MOTIONS.

Though not covered by any specification of error, petitioner's final attack is directed at the denial by the court below of his motions to recall the mandate and for leave to file a second petition for rehearing.[27] These motions presented the gravest jurisdictional

24. Petition, p. 6.
25. Petition, p. 6.
26. Petition, p. 6.
27. R. 61-62.

questions since they were made after the issuance of the mandate and after the expiration of the term at which the court's judgment of affirmance was entered.[28] In any event they were addressed to the discretion of the court. The proposed petition merely invited an examination of the record[29] in the hope that a different decision would be made on the issue of fact. The Circuit Court of Appeals properly refused such reexamination.

III. SUMMARY.

No question of law is presented by the petition here. The issue, the determination of which petitioner seeks by this court, is a pure issue of fact. The suggestion comes as an afterthought in view of decisions of this court subsequent to the trial in the District Court. In at least two cases in this court the Solicitor General has expressly distinguished the case at bar because of the factual situation which it presented. This court has accepted that view and has stated that the decision of the Circuit Court of Appeals in this case was not inconsistent with the views this court was expressing.

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28. *Sibbald v. United States*, 12 Pet. 488, 492; *Schell v. Dodge*, 107 U. S. 629; *Brooks v. Railroad Company*, 102 U. S. 107; *Bronson v. Schulten*, 104 U. S. 410, 415; *Ex parte National Park Bank*, 256 U. S. 131.

29. R. 64.

It is respectfully submitted that the petition for certiorari must be denied.

Dated, San Francisco, California,
July 16, 1934.

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INDEX.

	Page
Opinions below	1
Jurisdiction	1
Statutes involved	2
Statement	2
Summary of Argument	4
Argument	8
I. The Revenue Act of 1921 anthorized deductions of the losses suffered	8
II. It is not open to the petitioner to raise here the issue of double deduction	11
III. Even if the issue of double deduction were properly here, there would be no basis for concluding that there is a double deduction	14
IV. Discussion of the authorities	22
V. Discussion of minor contentions in petitioner's brief,	24
Conclusion	26
Appendix	27

CITATIONS.

CASES:

Apartment Corporation v. Helvering, 292 U. S. 631,	15, 16, 23
Atlantic City Co. v. Commissioner, 288 U. S. 152	24
Bates v. Coe, 98 U. S. 31, 47	12
Burnet v. Aluminum Goods Co., 287 U. S. 544,	7, 9, 20, 25
Burnet v. Riggs National Bank, 57 F. (2d) 980	9, 23
Duignan v. United States, 274 U. S. 195	12
Fleischmann Co. v. United States, 270 U. S. 349, 355–357	12

Page

Glenn v. Fant, 134 U. S. 398 13
Handy & Harman v. Burnet, 284 U. S. 136 . . 24
Ilfeld (Charles) Co. v. Hernandez, 292 U. S. 62, 69, 6, 7, 15, 16, 19, 20, 22, 23
Luckenbach v. McCahan Sugar Co., 248 U. S. 139, 145 14
Robinson & Co. v. Belt, 187 U. S. 41 . . . 12
Swift & Co. v. United States, 38 F. (2d) 365 (C. Cls.), 24
Texas & N. O. R. Co. v. Ry. Clerks, 281 U. S. 548. 558 14
United States v. Jefferson Electric Company, 291 U. S. 386, 407 12
United States Trust Co. v. New Mexico, 183 U. S. 535, 13
United States v. Lakewood Engineering Co., 70 F. (2d) 877 (C. C. A. 6th) 19, 23
Woolford Realty Co., v. Rose, 286 U. S. 319, 328 . 9
Wilson v. Merchants Loan & Trust Co., 183 U. S. 121, 13

STATUTE:

Revenue Act of 1921, c. 136, 42 Stat. 227, 254, 260:
Sec. 234 . . . . . 4, 8, 27
Sec. 240 27

REVISED STATUTES:

Sec. 649 . . . . . 14, 28
Sec. 700 . . . . . 12, 28

MISCELLANEOUS:

Treasury Regulations 11

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1934.

No. 125.

JOHN P. McLAUGHLIN, Collector of Internal Revenue for the First District of California, Petitioner,

v.

PACIFIC LUMBER COMPANY, a Corporation.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

No written opinion was filed by the District Court. The opinion of the Circuit Court of Appeals (R. 54–60) is reported in 66 F. (2d) 895.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered September 6, 1933 (R. 60). A petition for rehearing was filed October 4, 1933, and was denied February 23, 1934 (R. 60–61). Subsequently a motion for leave to file a second petition for rehearing and for reconsideration was filed May 1, 1934 (R. 61–62). This motion was denied May 7, 1934 (R. 65–66). On May 15,

1934, Mr. Justice Sutherland entered an order granting an extension of time for filing a petition for a writ of certiorari for a period of thirty days from May 23, 1934 (R. 67). The petition for a writ of certiorari was filed June 22, 1934. The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATUTES INVOLVED.

The statutes involved are set forth in the Appendix, *infra,* pages 27–28.

STATEMENT.

This action was instituted in the District Court for the Northern District of California by the respondent against the petitioner. That court rendered judgment for the respondent for $143,122.23 with interest, on account of overpayment of income taxes for the year 1923 (R. 30). The Circuit Court of Appeals affirmed (R. 60.)

The action was brought on account of failure of the Commissioner to allow as deductions for the taxable year losses sustained by the respondent corporation upon the liquidation of A. F. Thane & Company, a corporation which was a subsidiary of the respondent. Jury trial was waived by written stipulation.

The only evidence introduced was a stipulation of fact and certain tax returns. The evidence disclosed the following (R. 32–40): Respondent acquired the entire capital stock of A. F. Thane & Company. It owned 90 percent of its outstanding stock prior to 1920 and later purchased additional shares. During the period

between March 17, 1921, and the close of December 1923, the respondent advanced cash to and paid accounts for and assumed indebtedness of this subsidiary. In 1923 A. F. Thane & Company was dissolved. The proceeds in liquidation were insufficient to repay the respondent either the amount advanced to the subsidiary or the amount paid by respondent for the subsidiary's stock. The respondent charged off the unpaid balance on its books as a debt ascertained to be worthless during the year 1923.

The record does not show what the result of the operations of A. F. Thane & Company was prior to 1920 or whether consolidated returns including its income were filed prior thereto. The stipulation of facts does, however, show that during the years 1920, 1921, 1922 and 1923, A. F. Thane & Company suffered current losses which were reflected on consolidated returns filed by the petitioner and on which its income tax was computed. There is no evidence and no finding by the District Court as to what the net gain or net loss of the subsidiary was during the entire period of affiliation or that the losses suffered by the respondent on liquidation in 1923 were due to the operating losses of the subsidiary.

At the conclusion of evidence, each party moved for judgment and the plaintiff's motion was granted and the defendant's motion was denied. The defendant (*i. e.* petitioner here) excepted to this action of the Court. He did not request any finding of fact by the District Court and, of course, did not assign as error the failure of the District Court to make any finding.

The Court of Appeals concluded (R. 59):

". . . after an examination of the record and of the exhibits, we do not find that there is evidence to sustain the appellant's allegation of double deduction. The appellant has failed to establish any specific instance of such deduction. . . ."

SUMMARY OF ARGUMENT.

I.

The Revenue Act of 1921 authorized deduction of losses realized by a parent corporation upon an investment in a subsidiary corporation upon the liquidation of the subsidiary. Provisions of § 234 and similar provisions of other Acts have been so construed by the courts.

Although the petitioner's sole contention in the District Court was that no such loss was deductible, neither his specifications of error filed in this Court nor his brief here appears to raise this point.

There is no merit in the petitioner's contention that the losses suffered here were not losses "not compensated for by insurance or otherwise".

II.

It is not open to the petitioner to raise here the issue of double deduction. This issue was not raised in the District Court. The pleadings there did not even mention the existence of any losses in prior years or raise the issue of duplication. The agreed statement of facts did not stipulate that the liquidating losses upon which the respondent relied were connected with the prior operating losses of the subsidiary and there was no finding by the District Court to that effect. It made no

findings of fact and none was requested. It granted respondent's motion for judgment and denied a similar motion of petitioner.

Although petitioner excepted to these rulings, his exceptions raise at most the question whether there was substantial evidence fairly tending to support every element of the respondent's cause of action. Since there was such evidence, the judgment of the District Court can not be reversed.

An issue which is not pleaded and not raised in the District Court may not be considered on appeal.

Whatever effect may be given to the facts as stipulated, it is undeniable that there was no stipulation as to the ultimate fact which the petitioner now seeks to establish. The circumstance that there was an agreed statement of facts in this case can not serve to extend the scope of the review because there was no stipulation as to the ultimate fact, because the agreed statement of facts contained evidentiary matters, and because the parties reserved their rights to put in additional evidence and did so.

III.

Even if the issue of double deduction were properly here, there would be no basis for concluding that there is a double deduction.

We do not dispute the contention of the petitioner that it is improper to allow a double deduction. The Circuit Court of Appeals, however, expressly found that there was no evidence of a double deduction, and even if this Court should examine the evidence (as we assume it will not) we submit that on the record it must

come to the same conclusion as did the Circuit Court of Appeals.

The Solicitor General in briefs in previous cases has distinguished the instant case on the facts, and in *Charles Ilfeld Co.* v. *Hernandez,* 292 U. S. 62, 69, this Court said,

> "No decision other than that of the district court in *United Publishers' Corp.* v. *Anderson, supra,* gives any support to its[*i. e.,* the taxpayer's] claim. Cf. *Burnet* v. *Imperial Elevator Co.,* 66 F. (2d) 643. *McLaughlin* v. *Pacific Lumber Co.,* 66 F. (2d) 895."

The matter could not have been put more explicitly if this Court had said directly that this case was not like the *Ilfeld* case.

Although the petitioner now takes the position that there is no question of fact, this can mean nothing save that as a matter of law it is quite immaterial whether or not the operating losses in fact caused, contributed to or are reflected in the liquidating loss.

We submit, however, that the question which the petitioner seeks to raise can not be answered without knowing whether in fact the liquidating loss did reflect the operating loss, and it is not shown here that it did. The petitioner makes no attempt to explain why the finding of the Court below was wrong, but apparently takes the position that it could not possibly be right no matter what the facts were.

Because the income tax return of a subsidiary shows a loss, it does not follow that such a loss impairs the investment in its stock. Many items which enter into

actual operating losses or profits are eliminated from income tax returns, and the value of securities is influenced by many other things than mere appraisal of corporate assets.

Moreover, here there is no showing as to what the net results of the operations of the subsidiary were during the entire period of affiliation.

Whether or not a dissipation of assets is reflected in losses shown on income tax returns must depend upon the circumstances in each case. Here the record merely shows that there were such losses during part of the period of affiliation and a loss in investment upon liquidation of the subsidiary. This does not show that the two losses were the same.

IV.

The authorities do not support the contentions of the petitioner. The case chiefly relied upon by the petitioner, *Charles Ilfeld Co.* v. *Hernandez,* 292 U. S. 62, expressly differentiated that case from the instant case. The Circuit Court of Appeals in the instant case clearly regarded the *Ilfeld* case as not controlling. The different results reached in the two cases are justified by a difference in the facts in the two cases as found by the lower courts.

V.

Other points in petitioner's brief require but slight attention. Most of them are answered by the opinion of this Court in *Burnet* v. *Aluminum Goods Co.,* 287 U. S. 544, which holds that the dissolution of a subsidiary is such a closed transaction that it may result in an actual loss to the parent, deductible for income tax purposes.

The record here contains nothing which suggests any evasion of tax, and the holding in favor of the taxpayer does not invite evasion as the holding does not sanction double deductions.

ARGUMENT.

I.

THE REVENUE ACT OF 1921 AUTHORIZED DEDUCTIONS OF THE LOSSES SUFFERED.

The loss relied on by the respondent—*i. e.,* a loss realized by a parent corporation upon an investment in a subsidiary corporation upon the liquidation of the subsidiary—is a deductible loss under the Act of 1921. Although the petitioner's sole contention in the District Court was that *no such loss* was deductible, neither his specifications of error filed in this Court nor his brief here appears to raise this point.

The case is governed by Section 234 of the act which provided, *inter alia:*

> [illegible] computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or othewise; unless, in order to clearly reflect the income, the loss should in the opinion of the Commissioner be accounted for as of a different period. * * *
>
> (5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Comissioner, a reasonable addition to

a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;

* * * * *

There is no provision in the act which indicates that these provisions are not applicable to corporations filing consolidated returns.

These provisions were held to be applicable to a loss of the parent corporation on liquidation by the Circuit Court of Appeals for the Fourth Circuit in *Burnet* v. *Riggs National Bank,* 57 F. (2d) 980. This Court has held that similar provisions of the Revenue Act of 1916 permit deductions for losses of a parent corporation on liquidation. *Burnet* v. *Aluminum Goods Co.,* 287 U. S. 544.

As this Court said in *Woolford Realty Co.* v. *Rose,* 286 U. S. 319, 328:

> ". . . The fact is not be be ignored that each of two or more corporations joining (under § 240) [of 1926 Act] in a consolidated return is none the less a taxpayer. . . . 'The term "taxpayer" means any person subject to a tax imposed by this Act.' Revenue Act of 1922, [sic] § 2a(9). A corporation does not cease to be such a person by affiliating with another."

The Commissioner did not assert that under the provision of Section 234(a)(4) the specific loss now in question should be accounted for as of a different period.

The petitioner, however, now urges that the deduc-

tion claimed was not a loss "not compensated for by insurance or *otherwise*", within the meaning of the above section. The assignments of error filed in this Court appear to lay no foundation for this contention. No authority is cited in support of it, but petitioner's brief states "that the claimed deduction has already been compensated for by the losses returned by the consolidated group". (Petitioner's brief, p. 20.)

We submit that petitioner's argument is unsound for two reasons. First, as we demonstrate below, the two losses are different. Moreover, it is difficult to understand how any one can seriously contend that respondent has been *compensated* for this loss.

The right to deduct a loss from an income tax return is sorry *compensation*. The statute refers to compensation "by insurance or otherwise". When compensated by insurance the taxpayer gets back from the insurance company the amount of his loss; that is, he really suffers no loss. Petitioner's brief italicizes the words "or otherwise". Those words, however, must have the same connotation as the preceding words "by insurance". They refer to the same kind of full indemnity for the loss, for example, the payment which a tort feasor makes for the destruction of a taxpayer's property. When so compensated, the taxpayer really has suffered no loss. This is a very different situation from a case where the taxpayer has actually suffered a loss and has simply been allowed the partial relief which comes from a *pro rata* reduction of his income tax by deducting the loss in computing his net income.

The petitioner apparently does not base his argument upon any provision in the applicable regulations.

The applicable regulations cover expressly the situation existing upon the dissolution of a corporation. The paragraph entitled "Distributions in liquidation" provides:

> "If the amount received by the stockholder in liquidation is less than the cost or other basis of the stock, a deductible loss is sustained." (Regulations 62, article 1545.)

II.

It is Not Open to the Petitioner to Raise Here the the Issue of Double Deduction.

The sole issue presented to the District Court was not whether a double deduction existed, but whether as a matter of law the kind of loss alleged and proved by the respondent—*i. e.*, a loss upon the liquidation of the subsidiary company—could ever be deducted under the Revenue Act of 1921. The complaint by which the respondent instituted the action in the District Court set out that such a liquidating loss had been suffered in the year 1923. It did not refer to any prior loss. Nor did the answer of the petitioner set up the existence of any losses in prior years or raise the issue of duplication(R. 16–21). The agreed statement of facts did not contain any statement that the liquidating losses upon which the respondent relied were connected with any prior operating losses sustained by Thane & Company (R. 22–28).

The District Court made no findings of fact and was not requested to make any specific finding of fact.

Petitioner here moved for a nonsuit and judgment. Both motions were denied. Respondent's motion for judgment was granted. (R. 40–41.)

In the absence of special findings and requests for rulings of law, the only matter which can be considered is that which arises out of petitioner's exceptions to the court's action on motions for judgment. *Fleischmann Co.* v. *United States,* 270 U. S. 349, 355–357.

Petitioner's exceptions to these rulings, which are his only exceptions, raise at most the question whether there was substantial evidence fairly tending to support every element of the respondent's cause of action. *United States* v. *Jefferson Electric Company,* 291 U. S. 386, 407; R. S. Sec. 700 (p. 28, *infra*); since there was such evidence, the judgment of the District Court can not be reversed.[1]

It is, of course, established as a general principle that an issue which is not pleaded and not raised in a District Court may not be considered on appeal.

Bates v. *Coe,* 98 U. S. 31, 47.
Robinson & Co. v. *Belt,* 187 U. S. 41.
Duignan v. *United States,* 274 U. S. 195.

The circumstance that there was an agreed statement of facts in this case can not serve to extend the scope of the review because there was no stipulation as to that

[1] The assignments of error filed after the decision of the District Court do not specify as error the failure of the District Court to find that the operating losses were the same as, or caused, the investment loss. Even the points suggested in assignments of errors VI, VII, and VIII (R. 44–46) were not urged before the District Court.

ultimate fact which we contend must necessarily be found in order for the petitioner to prevail, *i. e.*, that the losses upon which the respondent bases its claim to a deduction were in fact the same losses or were caused by the losses sustained in earlier years by the subsidiary as operating losses. See pages 14 to 22 *infra.*

It is well settled that a statement of agreed facts which does not specifically cover all the ultimate facts necessary for a determination of the case can not serve as a substitute for a special finding so as to permit a general review of the sufficiency of the facts to support the judgment. *Wilson* v. *Merchants Loan & Trust Co.*, 183 U. S. 121; *United States Trust Co.* v. *New Mexico*, 183 U. S. 535; *Glenn* v. *Fant*, 134 U. S. 398.

Moreover, it should be noted that even with respect to the issue tried by the District Court, the facts stipulated do not amount to a stipulation of ultimate facts such as would constitute a case stated because the parties specifically reserved their right to introduce additional evidence and additional evidence in the form of exhibits was introduced. (R. 39, 40.) In this situation, where the record contains, in addition to the agreed facts, evidence of facts of an evidentiary nature leaving open questions as to the proper conclusions or inferences to be drawn therefrom, the case can not be reviewed as a case stated, nor can the agreed facts be taken as the equivalent of special findings. *Glenn* v. *Fant*, 134 U. S. 398, *supra.*

III.

Even if the Issue of Double Deduction Were Properly Here, There Would be No Basis for Concluding That There is a Double Deduction.

The petitioner argues that it is improper to allow a double deduction and we do not dispute that position.

The judgment of the District Court amounted to a general finding, and, by specific provision of R. S. § 649, (p. 28, *infra*), had the same effect as the general verdict of a jury.

Consequently its effect was to decide any and all issues in favor of the respondent here; and if there can be any review, all possible inferences must now be made in favor of the respondent. Hence, even if the petitioner can be deemed to have raised in the District Court the issue upon which he now relies, it nevertheless follows that such issue was resolved against him.

The Circuit Court of Appeals expressly found that there was no evidence of double deduction.

Whether the loss, the deduction of which is sought, is the same or a different loss must always be a question of fact. As to the fact, we assume that this Court will follow its usual practice in refusing to examine the evidence in view of the conclusions of the two lower courts. *Luckenbach* v. *McCahan Sugar Co.*, 248 U. S. 139, 145; *Texas & N. O. R. Co.* v. *Ry. Clerks*, 281 U. S. 548, 558. But even if this Court should examine the evidence, we submit that on the record it must come to the same conclusion as the Circuit Court of Appeals.

Counsel for the petitioner in opposing the petition for

certiorari in *Charles Ilfeld Co.* v. *Hernandez,* No. 579, October Term 1933, asserted that the decision of the Circuit Court of Appeals in that case was not in conflict with the decision of the Circuit Court of Appeals in the instant case. Combating the assertion that such conflict existed, the Government's brief in opposition stated that in our case,

> ". . . the court did not specifically hold that prior years' losses taken as deductions by the parent should not be offset against a loss on liquidation *but stated that the collector had failed to establish any specific instance of double deduction.*"[2] [Italics ours.]

The distinction so stated between the case at bar and the *Ilfeld* case was adopted by this Court in the *Ilfeld* decision. In the final paragraph of that decision this Court said (292 U. S. 62, 69):

> "No decision other than that of the district court in *United Publishers' Corp.* v. *Anderson, supra,*[3] gives any support to its [i. e. the taxpayer's] claim. Cf. *Burnet* v. *Imperial Elevator Co.,* 66 F. (2d) 643. *McLaughlin* v. *Pacific Lumber Co.,* 66 F. (2d) 895."

The matter could not have been put more explicitly if this Court had said directly that this case was not the same as the *Ilfeld* case.

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[2] No. 579 (October Term, 1933), Brief for Respondent in Opposition, p. 10. The statement is repeated in the same case in the Brief for the Respondent, pp. 26-27, and in No. 690 (October Term, 1933), *Apartment Corporation* v. *Helvering,* Memorandum for Respondent, p. 2.

[3] 42 F. (2d) 781.

Petitioner now takes the position flatly that there is no question of fact (petitioner's brief, p. 17). This can mean nothing save that as a matter of law it is quite immaterial whether or not the operating losses in fact caused, contributed to or are reflected in the liquidating loss, and that because of the mere fact that operating losses of the subsidiary were deducted on the consolidated returns, they must necessarily be offset against the liquidating loss. This theory of the Solicitor General is still inconsistent with his expressions in the *Ilfeld* and *Apartment* cases. In those cases he distinguished our case because of this finding of fact by the Circuit Court of Appeals for the Ninth Circuit. Now he says that that finding of fact is utterly immaterial.

The fallacy of petitioner's contention lies in confusing *amount of the investment* of the parent corporation in the subsidiary and the *amount of the assets* of the subsidiary. Some current operating losses of the subsidiary diminish its assets, and, *ipso facto,* diminish the assets of the consolidated unit of which it forms a part. Such losses are deductible as such. But it does not follow that every such loss necessarily involves a loss in the investment held by the parent corporation in the subsidiary. It may or may not do so, depending upon a variety of circumstances.

Many situations may be suggested, by way of illustration, in which an ultimate loss on the parent's investment in the subsidiary would in fact represent a new and independent loss in addition to previous operating losses incurred by the subsidiary and reflected in the

consolidated return of the business unit, even though the amounts might be equal. In such situations, no reduplication would occur though both deductions be allowed.

1. In 1917 Corporation A buys all the capital stock of Corporation B for $100,000, although its assets are worth $150,000. At the beginning of 1920, owing to operating profits or increase in value of capital assets, B's *assets* are worth $200,000. B incurs operating losses in that year amounting to $50,000. This represents a loss of $50,000 in the assets of the consolidated unit represented by A and B, and would appear as such in their consolidated return. The fact remains, however, that in spite of this loss, A's $100,000 investment in B has not been lost, for B still has assets of $150,000.

To continue the illustration, suppose that in the ensuing year B has further operating losses of $50,000. Again, the consolidated unit shows a loss in assets, but A's investment is still intact although operating losses to an equal amount ($100,000) have been incurred.

In the third year B is liquidated. Owing to a drop in the value of its capital assets, or some other cause, a further loss of $100,000 is sustained. A's investment is then wiped out. But this is clearly not the same loss as that suffered in prior years. It is a new loss. In allowing a deduction for it, there is no reduplication of any prior deduction.

2. Corporation A buys the stock of corporation B for $100,000. In the first year B suffers operating losses of $50,000. During the same year, however, B enjoys an appreciation of $50,000 in the value of its fixed assets, such as its plant. This gain, being unrealized, does not

appear upon the tax return of A and B. The only item that appears is the operating loss of $50,000, which is deducted as such in the consolidated return. Manifestly the operating loss thus appearing does not represent a loss of A's investment in B because the net value of B's assets remains the same. If, in a subsequent year, A's $100,000 investment is wiped out, this loss is not in any part a reduplication of the former loss, but is a new and additional one, and should be deductible as such.

3. Corporation A organizes Corporation B and subscribes for all of its capital stock, paying $100,000. B invests $100,000 in the stock of K, L and M, not members of the affiliated group. B borrows $100,000 from outsiders and invests in the stock of O, P and Q, likewise corporations not members of the affiliated group. During affiliation it pays $40,000 interest on the indebtedness, which is deducted in the consolidated return. During the same period, however, it receives as dividends on the stock of O, P and Q $50,000 (which does not appear as income in the consolidated return), and in turn it pays to A as dividends the excess over the amount of its interest payments. It sells the stock of O, P and Q for $100,000 and pays the indebtedness. A then dissolves B or else sells B's stock for the present value of its remaining assets, the stock of K, L and M, then worth $75,000. In either event, the dissolution or the sale creates a loss of $25,000 to A. It is true that the consolidated returns have shown deductions through the period of consolidation for the interest paid by B, which reduced the taxable income of A by $40,000. Those deductions, aggregating $40,000, how-

ever, in no way duplicate and have nothing to do with A's investment loss of $25,000.

The business of the subsidiary in this case was complicated, extensive and carried on both in the United States and foreign countries. As the record does not disclose the details we do not go into them. It is manifest, however, that the mere showing that, during the part of the period of affiliation, losses of the subsidiary have appeared on the consolidated returns aggregating an amount in excess of the investment loss of the parent on dissolution, does not show the existence of any duplication or double deduction.

Throughout his brief, petitioner entirely disregards the crucial question of fact whether in a case of this kind the operating loss actually is reflected in the liquidating loss. Thus, stating the question presented (petitioner's brief, p. 2) he states it to be whether the liquidating loss may be deducted when it is less than the operating losses deducted on consolidated returns. That question cannot be answered without knowing whether in fact the liquidating loss did reflect the operating loss. The first sentence under II, apparently the key note of the argument (p. 10), states absolutely and without qualification that the prior deduction of the operating loss would be duplicated by the subsequent liquidating loss. The facts in the *Ilfeld* and our case are recapitulated and compared (pp. 11–12) in entire disregard of the diverse findings of the Circuit Courts of Appeals on this important issue. The discussion of the facts in *United States* v. *Lakewood Engineering Co.*, 70 F. (2d)

887 (C. C. A. 6th), (p. 13) is similar. Reverting to our case, petitioner says "that (the liquidating) loss had already been suffered over a period of years and was already reflected in the consolidated returns" (p. 15). This was precisely contrary to what was found by the Circuit Court of Appeals for the Ninth Circuit. There is no attempt to explain why that finding was wrong. Apparently petitioner feels it could not possibly be right, no matter what the state of facts was.

He gives the same treatment to the bad debt deduction (p. 16). This failure to discriminate also appears in the passage where, referring to the prior losses, he says "to allow *their* deduction again as capital losses or worthless debts" (p. 17). The whole issue is whether the capital losses and worthless debts are in fact the same losses as those deducted as operating losses in the past in any sense of the word. On the same page he states as the rule of law in the *Ilfeld* case an absolute requirement that the earlier losses be offset against the liquidating loss and states this absolutely without the qualification we read into it from the *Aluminum* case. On the same page he says directly that the conclusion of the Court of Appeals about the lack of identification of the two losses was "beside the point". The same idea appears elsewhere in petitioner's brief.

The whole argument of petitioner is based upon the assumption that "as they (the operating losses) occurred they served to impair the capital value of the subsidiary" (p. 8). The unsoundness of this and of the basic assumption on which it is founded is apparent after a moment's consideration. The value of corporate securities, like any other problem, is not a matter of

arithmetic as simple as petitioner suggests. In the first place, the net profits and net losses reported on the income tax returns and which are the foundation of this whole discussion, were computed for the different companies in accordance with the requirements in the income tax law. Of course there are many items ordinarily classified as income which the law does not regard as income, and there are many items ordinarily classified as expense, the deduction of which the income tax law does not permit. Such items, however, affect the book value of the stock of a corporation, which is one of the things which we understand petitioner may mean by his phrase "capital value". Moreover, the receipt and payment of dividends, while swelling and depleting corporate assets, is counted out when we come to determine net income and net loss for tax purposes. There are many other instances of things of this kind, such as interest from tax exempt securities, etc. Moreover, it is common knowledge that corporate assets increase or decrease in actual value. Sometimes this is reflected on corporate books by credits and charges to surplus for write-ups and write-downs which, of course, are not reflected in income tax returns. Sometimes, the books are not changed to reflect these matters. Yet if by capital value petitioner means the real value, rather than a book figure, it is obvious that these things have to be considered. Finally, of course, there is the fact that the prices of securities are influenced by many other things than a mere appraisal of corporate assets.

The mere occurrence of an operating loss and a liquidating loss does not show whether they were or were not in truth the same.

IV.

Discussion of the Authorities.

Petitioner's brief relies heavily upon the case of *Charles Ilfeld Co.* v. *Hernandez,* 292 U. S. 62, and states that the facts in that case are identical with those in the instant case.

The short answer to this contention is that this Court by the final paragraph in its opinion in the *Ilfeld* case has clearly indicated the contrary. Moreover, it is to be remembered that the *Ilfeld* case arose under the Revenue Act of 1928 and regulations promulgated thereunder applicable to later years, in accordance with express authorization prescribed by the Act. This Court held the provisions of those regulations required the decision in the *Ilfeld* case; but, as we have pointed out, no such regulations are applicable to the year here involved, 1923.

The Circuit Court of Appeals in the instant case obviously did not regard the *Ilfeld* case as controlling. After the Circuit Court of Appeals for the Tenth Circuit decided the *Ilfeld* case, 66 F. (2d) 236, a petition for rehearing, based upon its decision, was filed in the Court of Appeals in the instant case. The Court denied the petition.

Subsequently the petitioner filed a motion for reconsideration, contending that the decision of this Court in the *Ilfeld* case (which had just been rendered) was controlling; but the Circuit Court of Appeals denied the motion.

To summarize, the different results reached by the

Circuit Court of Appeals for the Ninth Circuit in this case and by this Court and the Circuit Court of Appeals for the Tenth Circuit in the *Ilfeld* case, are due to a difference in the facts in the two cases, as found by them. In the *Ilfeld* case and in *The Apartment Corporation* case, the Solicitor General pointed this out explicitly. In the latter case, this Court denied *certiorari*. 292 U. S. 631.

The petitioner also relies upon *United States* v. *Lakewood Engineering Co.*, 70 F. (2d) 887 (C. C. A. 6th). It is obvious that in the *Lakewood* case (Pet. Br. p. 14) the taxpayer was making much the same kind of argument the petitioner is making here. He argued there that actual connection between the two losses was immaterial, that merely because the corporations were different "each is entitled to deduct the full amount of such loss". The paragraph in the opinion of the Court preceding that quoted by petitioner shows that the government's claim was that the taxpayer was "seeking to claim the same deduction twice". 70 F. (2d) 888. In the passage petitioner quotes, the Court says "it is difficult to escape the conclusion that the deductions are duplicated". The whole point at issue in the *Lakewood* case was the factual identity of the deductions, and the Court there held, as we urge here, that the deductibility or nondeductibility of the liquidating loss depends upon its identity, or nonidentity, with the operating loss already deducted, entirely apart from any arbitrary or artificial rules of law.

Again, in the *Riggs* case, the off-setting of the loss of the subsidiary for the current year was approved "be-

cause of the fact that *a part of this loss* had been deducted by the bank". (Pet. Br., p. 19.)

V.

Discussion of Minor Contentions in Petitioner's Brief.

There are other points in petitioner's brief somewhat remote from the real question, which may nevertheless be worthy of mention. Thus, he urges repeatedly that a group of affiliated corporations is a "single business enterprise". (Pet. Br., pp. 6, 8, 9 and 10). He refers to the prohibitions against intercompany transactions (pp. 6 and 7). Authorities upon which he relies are *Handy & Harman* v. *Burnet*, 284 U. S. 136 (Pet. Br., p. 6), and *Atlantic City Co.* v. *Commissioner*, 288 U. S. 152 (Pet. Br. p. 8), which merely determined the issues of affiliation *vel non.*

The petitioner's brief also relies upon *Swift & Co.* v. *United States*, 38 F. (2d) 365 (C. Cls.) (Pet. Br., p. 8). But the Court in that case did not say or hold, as petitioner contends, that the tax was to be computed "upon one income which is the true net income of such combined corporations". On the contrary, it said (p. 375) that the tax was to be computed "upon one income and one invested capital which is composed of the income and invested capital of such corporations combined". The Court did not postulate some extra-legal super-entity represented by the affiliated group and seek by mystic means to ascertain the net income of the group. It approved what has been the constant practice in the administration of the law, the ascertainment of the sep-

arate incomes of the affiliates, making the proper eliminations, and then the combination of these incomes. We submit that there is no special rule about double deductions in this connection. The general rule applies.

Another extraneous idea asserted in petitioner's brief is that in the nature of things there could be no loss upon a dissolution because "There was no act or occurrence which was not entirely within the control and power of the parent company; no outside group was affected; it was the mere dissolving of the form of an intercompany relation, which act of itself brought nothing into the affiliated group and saw nothing go out of the group" (Pet. Br., p. 15). This seems to be the argument that a dissolution is an intercompany transaction and, therefore, not a closed transaction.

Whatever these subsidiary arguments can mean, it is quite clear that the *Aluminum* case disposes of everything that could be said along these lines. The *Aluminum* case recognizes that intercompany transaction or no, the dissolution of a subsidiary is such a closed transaction that it may result in an actual loss to the parent, deductible for income tax purposes. This is precisely what the *Aluminum* case held, and all that it held.

Finally, petitioner advances the argument that the decision of the Circuit Court of Appeals for the Ninth Circuit opens the door to unfair evasion of taxes (Pet. Br., p. 18). But that court did not hold that a double deduction should be permitted. It merely held that the question whether the deduction was double or not is one of fact.

CONCLUSION.

The judgments of the Courts below should be affirmed.

Respectfully submitted,

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NOVEMBER, 1934.

APPENDIX.

Revenue Act of 1921, c. 136, 42 Stat. 227, 254, 260:

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; unless, in order to clearly reflect the income, the loss should in the opinion of the Commissioner be accounted for as of a different period. * * *

(5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commisioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;

* * * * *

SEC. 240. (a) That corporations which are affiliated within the meaning of this section may, for any taxable year beginning on or after January 1, 1922, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

Revised Statutes, Secs. 649, 700, as amended; U. S. Code, Title 28, Secs. 773, 875.

28 U. S. Code Sec. 773 (R. S. § 649). Issues of fact in civil cases in any district court may be tried and determined by the court, without the intervention of a jury, whenever the parties, or their attorneys of record, agree to waive a jury by a stipulation in writing filed with the clerk or by an oral stipulation made in open court and entered in the record. The finding of the court upon the facts, which may be either general or special, shall have the same effect as the verdict of a jury.

28 U. S. Code Sec. 875 (R. S. § 700). When an issue of fact in any civil cause in a district court is tried and determined by the court without the intervention of a jury, according to section 773 of this title, the rulings of the court in the progress of the trial of the cause, if excepted to at the time, and duly presented by a bill of exceptions, may be reviewed upon a writ of error or upon appeal; and when the finding is special the review may extend to the determination of the sufficiency of the facts found to support the judgment.

33

SUPREME COURT OF THE UNITED STATES.

No. 125.—October Term, 1934.

John P. McLaughlin, Collector of Internal Revenue for the First District of California, Petitioner, *vs.* Pacific Lumber Company. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 10, 1934.]

Mr. Justice Butler delivered the opinion of the Court.

Respondent brought this action in the district court for northern California to recover $143,122.23 it had paid as income tax for 1923. The complaint alleges facts upon which respondent claims to have been overassessed in that sum as a result of failure to take into account deductible losses. One loss ($479,625) resulted from the liquidation in 1923 of A. F. Thane & Company, a wholly owned subsidiary. The other ($953,134.49) was the indebtedness of that company to respondent, ascertained to be worthless and charged off by the latter in that year. Petitioner's answer put in issue some and admitted other allegations of the complaint. The parties stipulated for trial by the court without a jury. The evidence consisted of an agreed statement of facts and the separate and consolidated tax returns for 1920 to 1923, inclusive, of respondent, Thane & Company, and Pacific Lumber Company of Illinois. At the close of the evidence each party moved for judgment. The court denied petitioner's motion, granted that of respondent and gave it judgment in the amount sued for with interest and costs. The Circuit Court of Appeals affirmed. 66 F. (2d) 895.

The allegations of the complaint admitted by the answer, the agreed statement and the tax returns show:

During 1918 A. F. Thane & Company had outstanding 600 shares of capital stock of the par value of $100 each; respondent owned 540 for which it had paid $31,500 and A. F. Thane owned 60. In 1920, the company increased its capital to 5,000 shares, respondent subscribed and paid to the company par value, $100 per share, for 3,960 and Thane took the remaining 440 shares. In

1921 respondent bought these shares for $52,125 and so became the owner of all, for which it had paid $479,625. At the close of 1923, Thane & Company was dissolved and its remaining assets were transferred to respondent. Between March 17, 1921, and the end of 1923, respondent had advanced to it and paid for its account large sums. After deducting the amount repaid plus the value of the assets transferred at liquidation, Thane & Company was indebted to respondent in the sum of $953,134.49. Before the end of 1923, respondent charged this off as a debt ascertained to be worthless in that year.

From 1920 to 1923 inclusive, respondent, Thane & Company and the Pacific Lumber Company of Illinois made separate income tax returns and also consolidated returns as affiliated corporations. Their income taxes were paid on the latter basis. In each year respondent had a large net income and Thane & Company lost heavily; the Pacific Lumber Company of Illinois lost in the first and had relatively small net income in each of the other years.[1] Their separate returns for 1923 respectively showed net income of $1,379,494.78, net loss of $229,942.15, and net income of $8,809.83. The consolidated return reported net income of $1,158,362.46 on which respondent paid $144,795.31 as the total income tax. Upon examination and audit in the Bureau, a greater deduction was made for depreciation than was claimed in the return, overpayment was found in the amount of $1,673.08 and that was refunded.

Insisting that the losses here in question were deductible, respondent filed a claim for refund of the balance, $143,122.23. The letter of the deputy commissioner notifying it that the claim would be rejected stated that, since Thane & Company was affiliated with respondent and allowance was made, in computing consolidated net income, for all deductible losses sustained by the subsidiary during

	1920	1921	1922	1923
[1]Pacific Lumber Company of Maine, Respondent..	$2,262,959.39	$379,624.88	$1,266,450.51	$1,379,494.78
A. F. Thane & Company..	*443,821.95	*548,166.82	*344,791.49	*229,942.15
Pacific Lumber Company of Illinois	*23,052.35	18,314.97	31,198.03	8,809.83
Consolidated	$1,796,085.09	*$150,226.97	$952,857.05	$1,158,362.46

*Net loss.

The consolidated net loss of $150,226.97 for 1921 was allowed as a deduction from the consolidated net income for 1922, resulting in a consolidated net income for the latter year of $802,630.08, upon which the tax was paid.

the several years, a further deduction reflecting directly or indirectly the same losses was not allowable. And the claim was disallowed.

Petitioner's motion at the close of the evidence for judgment in his favor raised the question of law whether the evidence is sufficient to warrant judgment for respondent and the trial court's decision of that question was reviewable in the Circuit Court of Appeals and is here for decision. *United States* v. *Jefferson Electric Co.*, 291 U. S. 386, 407.

Section 240 (a) of the Revenue Act of 1921 declares: "That corporations which are affiliated within the meaning of this section may . . . make separate returns or under regulations prescribed . . . make a consolidated return of net income . . . in which case the taxes thereunder shall be computed and determined upon the basis of such return." 42 Stat. 227, 260. Treasury Regulations 62 provide: "Consolidated returns are based upon the principle of levying the tax according to the true net income and invested capital of a single enterprise . . . [Art. 631.] Subject . . . to the elimination of intercompany transactions . . . the consolidated taxable net income shall be the combined net income of the several corporations consolidated." Art. 636.

If not inconsistent with its obligation under the statute accurately to report taxable income for 1923, respondent may deduct the losses it sustained in that year as the result of its investment in the stock of Thane & Company and its advances to or for that company. *Burnet* v. *Aluminum Goods Co.*, 287 U. S. 544, 550. But a consolidated return must truly reflect taxable income of the unitary business and consequently it may not be employed to enable the taxpayer to use more than once the same losses for reduction of income. Losses of Thane & Company that were subtracted from respondent's income are not directly or indirectly again deductible. *Handy & Harman* v. *Burnet*, 284 U. S. 136, 140. *United States* v. *Ludey*, 274 U. S. 295, 301. *Ilfeld Co.* v. *Hernandez*, 292 U. S. 60, 68. Respondent voluntarily paid the tax. When disallowing the claim for refund, the Bureau notified it that losses in 1923 reflecting other deductions would not be allowed. Presumably respondent had within its control the records showing facts that would fully disclose the relations between such losses and those reported in the returns of Thane & Company. The Circuit Court

of Appeals states that there is no evidence of double deduction or any specific instance of such deduction. But that absence of proof does not support the judgment. Respondent had the affirmative of the issue, and the burden was on it to show that allowance of the deduction claimed would not amount to twice subtracting the same loss. That is an essential fact which cannot be assumed. Respondent may not rely on mere assertion or speculation. *Cochran* v. *United States,* 254 U. S. 387, 393. *Fidelity Title Co.* v. *United States,* 259 U. S. 304, 306. *United States* v. *Anderson,* 269 U. S. 422, 443. *Compañia General* v. *Collector,* 279 U. S. 306, 310. *United States* v. *Jefferson Electric Co., supra,* p. 400.

The evidence not only fails to establish that essential fact but is little, if any, less than enough to show that the allowance of the deductions claimed would be a second use of the same losses. The details, given in the tabular statement printed in the margin of an earlier page of this opinion, show that the losses of Thane & Company, which operated through consolidated returns to reduce respondent's income taxed, amount in all to more than respondent's asserted 1923 losses and to more than its income taxed in that year. Thane & Company's statements attached to its separate tax returns show liabilities in excess of assets in each year of the affiliated period increasing annually until by the end of 1923 the deficit had become $1,453,134.49. Prior to 1920 Thane & Company had outstanding only $60,000 of capital stock, 90 per cent. of which was acquired by respondent for less than par. During the affiliated period its deductible losses amounted to more than three times its capital. While it is conceivable that, as suggested by respondent, the losses do not necessarily indicate that thereby Thane & Company became unable to pay its debts, the circumstances tend strongly to indicate that they did cause its breakdown resulting in respondent's 1923 losses here claimed. If these losses did not cause, or are not reflected in, those sustained by respondent in 1923 as the result of its investment in and advances to that company, it reasonably may be presumed that respondent would have shown that fact.

The trial court should have granted petitioner's motion for judgment in his favor.

Reversed.